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No. 10-__

IN THE

Supreme Court of the United States

COUNCIL TREE INVESTORS, INC., BETHEL NATIVE CORPORATION, AND THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 706 of the Administrative Procedure Act, 5 U.S.C. § 706, provides that a reviewing court "*shall*— (1) compel agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful and set aside agency action . . . found to be . . . not in accordance with law . . . [or] without observance of procedure required by law" (emphasis added). In this case, the United States Court of Appeals for the Third Circuit held that the Federal Communications Commission conducted two licensing auctions for electromagnetic spectrum pursuant to seriously deficient, unlawfully promulgated rules. Those new rules effectively precluded significant participation by small businesses in the spectrum licensing auctions, contrary to 47 U.S.C. §§ 309(j)(3)(B) and (4)(D), which require the Commission to design its auctions so as to promote the participation of small businesses therein and to avoid the excessive concentration of licenses. Despite the APA's mandatory language, the Third Circuit concluded that it had discretion to decline to set aside the results of the licensing auctions, or order any other remedy for petitioners' effective exclusion from the auctions, in conflict with the decisions of other circuits. The question presented is:

Whether a reviewing court has the discretion under Section 706 of the APA to decline to set aside, or provide any remedy for, unlawful agency action?

PARTIES TO THE PROCEEDING BELOW

The petitioners in this case include Council Tree Investors, Inc., Bethel Native Corporation, and the Minority Media and Telecommunications Council.[1]

The respondents include the Federal Communications Commission and the United States of America.

The intervenors on the side of respondents include CTIA – The Wireless Association, T-Mobile USA, Inc. and Cellco Partnership d/b/a Verizon Wireless.

CORPORATE DISCLOSURE STATEMENT

No petitioner has a parent company and no publicly held company owns 10% or more of the stock of any petitioner.

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[1] At the time of the December 1, 2009 oral argument before the Third Circuit, Council Tree Investors, Inc. informed the court of its name change from Council Tree Communications, Inc., but this change was not reflected in the case caption of the court's opinion.

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PETITION FOR A WRIT OF CERTIORARI

Petitioners Council Tree Investors, Inc. ("Council Tree"), Bethel Native Corporation ("BNC"), and The Minority Media and Telecommunications Council respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-51a) is reported at 619 F.3d at 235.

JURISDICTION

The judgment of the court of appeals was entered on August 24, 2010. Pet. App. 1a. Justice Alito extended the time for filing the petition to and including December 22, 2010. No. 10A467. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISIONS

Reproduced in an appendix to this petition are the relevant provisions of (1) the Administrative Procedure Act, 5 U.S.C. §§ 500 *et seq.* ("APA"); and (2) the Communications Act of 1934, as amended, 47 U.S.C. §§ 151 *et seq.* ("Communications Act").

STATEMENT OF THE CASE

I. Introduction

This petition presents a question of vital importance concerning the remedy required under

the APA for unlawful agency action. In this case, the Third Circuit held that the Federal Communications Commission ("FCC" or "Commission") had conducted two important spectrum licensing auctions pursuant to unlawful rules. Those rules pervasively excluded small businesses, including petitioners, from competing in the auctions, contrary to key provisions of the Communications Act that require the FCC to take steps to prevent concentration of the nation's airwaves in the hands of large incumbent carriers. Although the Third Circuit set aside the rules as unlawfully promulgated, and did not question their devastating consequences for small businesses in the auctions, the court of appeals declined to set aside the auction results or order any other relief for petitioners' injuries. That decision was premised on that court's view that Section 706 of the APA – which provides that a reviewing court "shall . . . set aside" unlawful agency action – allows reviewing courts significant remedial discretion, including the authority to decline to set aside or otherwise remedy such unlawful action. That interpretation of the APA is the subject of deep and historic divisions within the circuits that should be resolved by this Court in this case.

II. Statutory/Regulatory Framework

1. The Communications Act of 1934, as amended, 47 U.S.C. §§ 151 *et seq.*, directs the FCC to auction licenses for publicly-owned electromagnetic spectrum. 47 U.S.C. § 309(j) (2006). Congress viewed the auctions as an opportunity to allow new entrants into a heavily concentrated telecommunications industry and, therefore, in order to prevent the largest and

best-financed incumbent companies from dominating licensing auctions, Congress directed the FCC to design an auction system that seeks to "promot[e] economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses . . . ," while also seeking the "avoidance of unjust enrichment through the methods employed to award" licenses. *Id.* §§ 309(j)(3)(B), (C); *see also id.* § 309(j)(4)(D). Small business entities Congress intended to assist are classified by the FCC as "designated entities," 47 C.F.R. § 1.2110(a) (2005), also known in agency parlance as "DEs."

The FCC implemented these directives through a number of regulatory measures. To help DEs counteract the substantial financial advantages enjoyed by incumbents, FCC regulations grant DEs auction "bidding credits" that reduce the amounts winning DEs pay by a specified percentage. *Id.* § 1.2110(f) (2005). The amount of the credit varies with the average gross annual revenues for the preceding three years of the entity controlling the DE. *Id.* § 1.2110(f)(2)(i)-(iii) (2005). To avoid "unjust enrichment," however, the FCC imposes a graduated system of penalties on a DE that loses DE eligibility or sells its acquired spectrum licenses to a non-DE within a specified period of time after acquisition, a period set at five years for almost a decade prior to the rulemaking challenged in this case. Pet'rs Br. 7 n.7; *see also* 47 C.F.R. § 1.2111(d)(2) (2005).

At the same time, the Commission historically recognized that it was unrealistic to think that new entrant DEs could immediately amass enough capital

not only to build new wireless network facilities, but also to sell telecommunications services directly to customers in retail competition with large, entrenched incumbents. Consequently, FCC regulations and policies historically endeavored to promote competition by allowing DEs the flexibility to sell spectrum at wholesale and to lease substantial quantities of spectrum to third parties, without triggering the unjust enrichment penalties.[2] By allowing successful DE bidders to generate immediate sources of wholesale and resale revenue, the Commission enabled startup DEs to attract outside investors who would otherwise be unwilling to risk waiting for such new businesses to try to establish themselves in the retail marketplace against such long competitive odds. With such flexibility, DEs could use their licenses to compete with the largest incumbents through such means as alliances with other companies, already established in that marketplace, that have an abiding need for additional spectrum capacity.

2. The promulgation of these regulations, their subsequent amendment, and the licensing auctions themselves, are governed by the APA, 5 U.S.C.

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[2] Pet. App. 40a (quoting *In re Promoting Efficient Use of Spectrum Through Elimination of Barriers to the Development of Secondary Markets*, Report and Order and Further Notice of Proposed Rulemaking, 18 F.C.C.R. 20604, 20654-55 (2003)). The "leasing" model allows a *lessee* to use spectrum leased from a DE to provide service to consumers over technical facilities which that *lessee* has already constructed and owns, whereas the "wholesale" model calls for the DE that owns the spectrum to build out and operate new technical facilities and then *wholesale* spectrum capacity to third parties who provide service to consumers.

§§ 551(13), 553. Section 553 of the APA obligates agencies to publish in the Federal Register "[g]eneral notice of proposed rule making," including "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. § 553(b)(3) (2006). These requirements "serve important purposes of agency accountability and reasoned decisionmaking," that are at the core of the APA. *Am. Med. Ass'n v. Reno*, 57 F.3d 1129, 1132 (D.C. Cir. 1995).

The statute further prohibits agency action that is "arbitrary [or] capricious," and creates a private right of action to challenge agency violations of law. 5 U.S.C. §§ 702, 706(2)(A) (2006). As part of the Act's enforcement regime, Section 706 mandates that a court reviewing challenged agency action

> shall—(1) compel agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful and set aside agency action . . . found to be . . . not in accordance with law . . . [or] without observance of procedure required by law.

Id. §§ 706(1), 706(2)(A), (D).

III. Procedural History

1. In 2006, the FCC conducted a major auction (referred to as "Auction 66") for licenses for large amounts of highly desirable electromagnetic spectrum allotted for the provision of advanced wireless services.[3] Petitioners and other DEs

[3] The FCC had begun planning for Auction 66 many years earlier. *See generally Second Report and Order*, ET Docket No. 00-258, 17 F.C.C.R. 23193 (2002).

engaged in extensive preparations to participate in the auction, negotiating partnerships and working to obtain investment funding from various sources based on the then-existing DE rules. *See* CA-JA 1267-68, 1277, 1537-38.[4]

In February 2006, just three months before applications were due for the scheduled June 2006 commencement of Auction 66, the FCC announced that it was undertaking a rulemaking to make certain limited modifications to the DE program, to be applied to the upcoming Auction 66 and all subsequent auctions.[5] In particular, the Commission proposed to preclude certain material relationships between DEs and large, in-region incumbent wireless carriers and also requested comment on whether to extend any such limitations to DE relationships with other large companies with significant communications interests. The FCC gave no indication that it was contemplating any larger changes, and petitioners Council Tree and BNC continued to prepare for Auction 66.

However, in April 2006, a little more than two weeks before Auction 66 applications were due, the

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[4] The administrative record contained in the Joint Appendix and Supplemental Joint Appendix before the Third Circuit is hereby cited to as "CA-JA" or "CA-SJA," respectively.

[5] *See Further Notice of Proposed Rule Making*, WT Docket No. 05-211, 21 F.C.C.R. 1753 (2006). CA-JA 60.

FCC issued final rules[6] that bore no resemblance to those in the proposed rulemaking and instead dramatically altered the DE regulations in ways that substantially harmed DEs, ultimately preventing petitioners from competing with the incumbent carriers in Auction 66 and any subsequent licensing auction. In particular, the new rules:

(1) *doubled* the unjust enrichment penalty repayment period from five to ten years ("Ten Year Rule") and made corresponding changes in the related schedule of graduated repayment penalties over those ten years, including the imposition of a 100 percent bid credit repayment obligation (plus interest) during the first five years;[7]

(2) *eliminated* DE eligibility altogether for any entity that leased or resold (including on a wholesale basis) to third parties more than 50 percent of the aggregate spectrum capacity won at auction ("50 Percent Rule");[8] and

(3) through changes in the rules for determining a DE's gross revenues (and, therefore, its

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[6] *Second Report and Order and Second Further Notice of Proposed Rule Making*, WT Docket No. 05-211, 21 F.C.C.R. 4753 (2006) ("*Second R&O*"), CA-JA 82, *recon. granted in part and denied in part sua sponte, Order on Reconsideration of the Second Report and Order*, WT Docket No. 05-211, 21 F.C.C.R. 6703 (2006) ("*First Reconsideration Order*"), CA-JA 142, *recon. denied, Second Order on Reconsideration of the Second Report and Order*, WT Docket No. 05-211, 23 F.C.C.R. 5425 (2008) ("*Second Reconsideration Order*"), CA-SJA 29.

[7] *See* 47 C.F.R. § 1.2111(d)(2)(i) (2006) (now vacated).

[8] *See id.* § 1.2110(b)(3)(iv)(A) (now vacated).

eligibility for DE status), effectively limited DEs to leasing or reselling (including on a wholesale basis) to any single third party no more than twenty-five percent of the aggregate spectrum capacity won at auction ("25 Percent Rule").[9]

2. Petitioners immediately challenged the new rules as adopted in contravention of the APA notice and comment provisions and as substantively arbitrary and capricious. In a petition for reconsideration (and expedited request for stay) filed with the FCC, CA-JA 1279 and 1245, respectively, petitioners pointed out that the 11th hour rule changes had emerged without warning from a proceeding that was originally focused primarily on whether to limit large incumbent wireless service provider involvement in the DE program. *See id.* at 1281 and 1285.

Petitioners further pointed out that substantively, the new rules would have a devastating effect on DEs' business plans and access to capital in Auction 66, by driving away those able and willing to invest in DEs. *Id.* at 1254-1255. Petitioners emphasized that no rational investor would tolerate having to retain ownership of an expensive asset for *ten years* without a viable exit plan in a field as dynamic as telecommunications. *Id.*

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[9] The rule accomplished this result by attributing to each DE the gross revenues of any company to which it leased or resold this amount of spectrum capacity, which would in most cases have the effect of putting the DE's gross revenues above the maximum level permitted for DE status eligibility. *See id.* § 1.2110(b)(3)(iv)(B) (2006).

Moreover, the 50 Percent Rule effectively required all DEs to use at least half of their spectrum to compete directly with entrenched incumbents in the *retail* marketplace, where an incumbent's advantages are most pronounced (*e.g.*, advertising, storefront presence, branding). *See id.* at 1524, 1558. The combination of rules deprived DEs of flexibility essential to attracting start-up capital, causing the immediate withdrawal of petitioners' private equity investors and significant strategic partners cultivated over many months. *See id.* at 1527, 1538.[10]

3. The FCC declined to grant petitioners' reconsideration and stay requests, although some Commissioners expressed ambivalence and concern about the new DE rules. FCC Chairman Kevin Martin stated his belief that these "last-minute" changes were not "needed" but that he agreed to them only to "obtain the support" necessary to ensure that the Auction 66 would be held in the Summer of 2006. CA-JA 166. Commissioner Jonathan Adelstein, who had earlier noted that the rule changes were made on an "incredibly aggressive" timetable, *id.* at 80, worried on reconsideration that they, and the FCC's subsequent "legal maneuvering" in the "troubled proceeding," might "prove to be the undoing of [the FCC's] most significant auction in 10 years." *Id.* at 168.

Petitioners sought an emergency stay of the rule changes and of Auction 66 from the Third Circuit.

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[10] In fact, the rule revisions prevented Council Tree from bidding to implement a business plan that called for the emergence of a new nationwide competitive wireless carrier network. Pet'rs Supp. App. V, Tab 1.

The court of appeals denied the stay and the auction proceeded. Pet. App. 24a-26a.

4. Petitioners' objections proved prophetic, as the new rule changes ultimately had a dramatic impact on DE performance not only at Auction 66, but also at a second major spectrum licensing auction, "Auction 73," conducted pursuant to the new DE rules early in 2008. Historically, DEs had won on average 70% of auction licenses, measured by value. *Id.* at 26a-27a.[11] But DEs won just 4% of the nearly $14 billion worth of auctioned licenses in Auction 66. *Id.* at 26a. In contrast, four large bidders won 78% of the total dollar value of the licenses auctioned. Pet'rs Supp. App. III, Tab 1, Exh. H.

Those results were so startling that the Office of Advocacy of the U.S. Small Business Administration asked the FCC to suspend application of the demonstrably harmful new rules to Auction 73. Pet'rs Supp. Br. 8 n.12. The FCC summarily rejected that request,[12] and the results in Auction 73 were even worse. That auction generated more than $19 billion in winning bids, but DEs' percentage of the total dollar value fell even more precipitously, to 2.6%. Pet. App. 27a. Just two companies, Verizon Wireless and AT&T Wireless, captured more than 84% of the total dollar value of the licenses auctioned. Pet'rs Supp. App. III, Tab 1, Exh. I.

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[11] That is, in an auction that garnered $100 million in winning bids, DEs typically purchased approximately $70 million worth of spectrum.

[12] *See Second Report and Order*, WT Docket No. 06-150, 22 F.C.C.R. 15289, 15472 n.1083 (2007).

Thus, despite Congress's intent that the auctions be structured to increase competition and avoid concentration of spectrum licenses in the hands of a few dominant carriers, under the new rules, by 2008, only four companies controlled 90% of subscribers in the mobile telephone market, up from 62.6% controlled just five years earlier by the top four companies.[13]

5. Petitioners sought judicial review of the rule changes and both licensing auctions in the Third Circuit.[14] On August 24, 2010, the Third Circuit issued its opinion, striking down the most significant rule changes but declining to vacate the license sales or provide any remedy for petitioners' effective exclusion from the auctions.

a. The court first narrowly upheld the 25 Percent Rule, although it found it a "close" question whether the rule was arbitrary and capricious, given its effect

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[13] *Compare Annual Services Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile*, Ninth Report, WT Docket No. 04-111, 19 F.C.C.R. 20597, 20697 (2004) (reporting 2003 subscriber by carrier data), *with Annual Services Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile*, Fourteenth Report, WT Docket No. 09-66, 25 F.C.C.R. 11407, 11648 (2010) (reporting 2008 subscriber by carrier data).

[14] The court ruled that petitioners' initial petition was premature, as the Commission had not yet issued a final order disposing of petitioners' request for reconsideration of the rule changes. *See Council Tree Comm'ns v. FCC*, 503 F.3d 284, 293 (3d Cir. 2007). When the Commission continued to fail to act on the reconsideration petition, petitioners sought a writ of mandamus, after which the Commission finally denied reconsideration. *Second Reconsideration Order*, *supra* note 6. Petitioners then filed the present case in the Third Circuit.

on DEs' ability to raise capital and the FCC's limited justification for the rule. Pet. App. 34a.

Turning to the 50 Percent and Ten Year Rules, the court expressed serious doubt whether either was substantively lawful. The panel "note[d] that the FCC does not appear to have thoroughly considered the impact of the extended repayment schedule on DEs' ability to retain financing." *Id.* at 46a n.10. It further found that the Commission was "confused" about "the maximum period for which investors are willing to lock up their capital (before being able to liquidate the spectrum license, in the event the DE proves unprofitable) . . . ." *Id.* at 46a-47a n.10. Likewise, the court criticized the agency's "inattention to the nature of the wireless wholesaling business," in which a DE would "build and operate" new, wireless transmission facilities and then sell that new capacity to other existing companies, thereby promoting competition. *See id.* at 42a n.8.

Ultimately, however, the court concluded that it did not have to decide whether the rule changes were arbitrary and capricious, because they were made in clear violation of the APA's notice and comment requirements. *Id.* The court found that the "contrast could not be more stark between the transparent discussion of [the issues in a prior rulemaking] and the run up to the rules promulgated in 2006." *Id.* at 41a. In this case, the Further Notice of Proposed Rulemaking "had not so much as hinted that" the Commission was contemplating anything like the 50 Percent Rule. *Id.* at 39a. Similarly, the court found that the FCC had failed to provide even "inferential notice" of the Ten Year Rule, *id.* at 44a, observing that "[i]ndeed, no commenter manifested

an understanding that the FCC was considering changing the existing repayment schedule." *Id.* at 45a.

b. The court then turned to remedy. The FCC and intervenors had argued that, even if the rules had been issued in violation of the APA, the Third Circuit should provide no remedy for petitioners' injuries, but should instead leave undisturbed both the auction results and the illegally issued rules, while remanding the case to give the Commission an opportunity to retain the rules pursuant to proper procedures. *See id.* at 47a. In the alternative, the Commission and intervenors argued that if petitioners were entitled to a remedy for their injuries, the court should either vacate the rules and leave the auctions intact, or follow precedent from the D.C. Circuit and remand the case to allow the Commission to craft appropriate alternative relief relating to the auctions. *Id.* at 49a; *see also* Resp'ts Supp. Br. 33-34 (citing *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1171-72 (D.C. Cir. 1987)); Intervenors CTIA - The Wireless Association and T-Mobile USA, Inc. Supp. Br. 16-17 (citing, *inter alia*, *Freeman Eng'g Assocs. v. FCC*, 103 F.3d 169 (D.C. Cir. 1997)).

Petitioners, on the other hand, argued that a remand without vacatur was impermissible, noting that "[t]he APA's command that '[t]he reviewing court shall . . . set aside [unlawful] agency action,' 5 U.S.C. § 706(2)(A), means quite straightforwardly, that 'a "reviewing court" . . . "shall" – **not may** – "hold unlawful and set aside" the agency action. Setting aside means vacating; no other meaning is apparent.'" Pet'rs Supp. Br. 25 n.43 (quoting

Checkosky v. SEC, 23 F.3d 452, 491 (D.C. Cir. 1994) (Randolph, J., dissenting in part) (emphasis in original) (some internal citations omitted)). Petitioners further insisted that a "prospective-only" remedy that set aside the rules for future auctions, but provided no remedy for the past harm done to DEs, would be entirely inadequate. *Id.* at 36. Instead, they asked the Third Circuit to set aside the rules and, as this Court had done in *FCC v. NextWave Personal Communications Inc.*, 537 U.S. 293 (2003), vacate the auction results. Pet'rs Supp. Br. at 25-26; Pet'rs Reply Br. 23, 28.

In light of the "serious" deficiencies in the rulemaking process, the Third Circuit denied the Commission's request for remand without vacatur of the Ten Year Rule and the 50 Percent Rule ("Vacated Rules"), without resolving there petitioners' claim that the plain language of the APA deprived the court of the discretion to decline to set aside an unlawful agency action. Pet. App. 49a & n.13. The court did not hesitate, however, to treat its decision of whether to set aside the rest of the challenged agency action – the FCC's licensing auctions conducted pursuant to the Vacated Rules – as a matter of equitable discretion. It concluded that the difficulties and assumed inequities of reinitiating the spectrum license sales justified providing no remedy at all with respect to the auctions themselves. *Id.* at 48a. The court did not dispute that the FCC has been required to vacate the results of unlawfully conducted auctions in the past, as demonstrated in *NextWave*. And the court acknowledged that it would be possible to mitigate the impact of a rescission by allowing winning bidders to maintain their licenses "unless

and until they are won by another bidder at re-auction." *Id.* Nonetheless, the court concluded that "it would be imprudent and unfair to order rescission of the auction results." *Id.* at 49a.

At the same time, the court declined to order any other relief to compensate for the unfairness to petitioners inherent in refusing to vacate the spectrum license sales or to remand the case to the FCC to consider whether some alternative form of relief was appropriate and available to address petitioners' injuries. *See id.*

REASONS FOR GRANTING THE WRIT

This case raises important questions concerning the remedy required by Section 706 of the APA, 5 U.S.C. § 706, when the court finds that a federal agency has acted unlawfully. The decision below adds to a deep and historic division of authority within the circuits.

I. This Court Should Resolve The Division Among The Courts Of Appeals On The Important Question Of Whether Section 706 Deprives Reviewing Courts Of The Discretion To Decline To Set Aside Unlawful Agency Action.

This case presents the Court with an opportunity to address and resolve an unsettled issue of profound and recurring importance within the field of administrative law. Under Section 706, a "reviewing court *shall*— (1) *compel* agency action unlawfully withheld or unreasonably delayed; and (2) hold unlawful *and set aside* agency action . . . found to be— (A) arbitrary, capricious, an abuse of discretion,

or otherwise not in accordance with law; . . . [or] (D) without observance of procedure required by law." 5 U.S.C. § 706 (emphasis added). Some circuits have held that this seemingly mandatory language is permissive, allowing courts to exercise equitable discretion to decline to set aside unlawful agency action. Others have read the same language to mean precisely the opposite, construing "shall" to preclude any room for equitable discretion. The conflict is considered and will not be resolved absent a decision from this Court. Accordingly, as a leading treatise has noted, "[t]he Supreme Court needs to resolve the growing dispute about the range of remedies available to a reviewing court when the court detects one or more flaws or gaps in an agency's reasoning in support of a rule." Richard J. Pierce, Jr., *Administrative Law Treatise* § 7.13, at 693 (5th ed. 2010).

A. The Circuits Are Intractably Divided Over Whether Courts Retain Discretion To Refuse To Set Aside Unlawful Agency Action Under Section 706.

For many years after enactment of the APA, the practice of vacating unlawful agency action as a matter of course was "generally accepted and relatively uncontroversial." American Bar Association, Section of Administrative Law and Regulatory Practice and Business Law, Report to the

House of Delegates 1, 1 (1997).[15] By the early 1990s, however, the D.C. Circuit had confirmed its departure from the plain language of Section 706 in favor of exercising equitable discretion to remedy APA violations. That practice has also been adopted by the Ninth and now the Third. However, the Tenth Circuit has directly rejected these Circuits' interpretation of Section 706, concluding that the provision's mandatory language means what it says.

1. Under the D.C. Circuit's "remand without vacatur" practice, an "inadequately supported rule . . . need not necessarily be vacated." *Comcast Corp. v. FCC*, 579 F.3d 1, 8 (D.C. Cir. 2009) (quoting *Allied-Signal, Inc. v. U.S. Nuclear Regulatory Comm'n*, 988 F.2d 146, 150 (D.C. Cir. 1993)). Instead, "[t]he decision whether to vacate depends on the seriousness of the [rule's] deficiencies . . . and the disruptive consequences of an interim change that may itself be changed." *Comcast*, 579 F.3d at 8 (quoting *Allied-Signal*, 988 F.2d at 150-51); *see, e.g.*,

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[15] *See also* Merrick B. Garland, *Deregulation and Judicial Review*, 98 Harv. L. Rev. 505, 568 (1985) ("Traditionally, courts faced with an arbitrary and capricious regulatory decision . . . normally vacate[] the decision and remand[] the matter to the agency for further proceedings 'consistent with' the court's opinion."); Ronald M. Levin, *Vacation at Sea: Judicial Remedies and Equitable Discretion in Administrative Law*, 53 Duke L.J. 291, 298 (2003) ("Until recently, reviewing courts routinely vacated agency actions that they found to have been rendered unlawfully. That practice was generally accepted and essentially taken for granted."); Richard J. Pierce, Jr., *Seven Ways to Deossify Agency Rulemaking*, 47 Admin. L. Rev. 59, 75 (1995) ("Until the 1990s, a reviewing court routinely vacated and remanded an agency rule if the court held the rule arbitrary and capricious . . . .").

Natural Res. Def. Council v. EPA, 489 F.3d 1364, 1374-75 (D.C. Cir. 2007); *see In re Barr Labs., Inc.*, 930 F.2d 72, 74-76 (D.C. Cir. 1991).

Judges within the D.C. Circuit have objected that the court's remand without vacatur practice cannot be squared with the plain language of Section 706. Judge Randolph, for example, has argued the APA requires "in the clearest possible terms" that a reviewing court faced with an unlawful "agency decision 'shall' – **not may** – 'hold unlawful and set aside' the agency action." *Checkosky v. SEC*, 23 F.3d 452, 491 (D.C. Cir. 1994) (Randolph, J., dissenting in part) (emphasis in original). Remanding without vacating, therefore, is "contrary to law. It rests on thin air. No statute governing judicial review of agency action permits such a disposition and the controlling statute – 5 U.S.C. § 706(2)(A) – flatly prohibits it." *Id.* at 490; *accord Comcast Corp.*, 579 F.3d at 10 (Randolph, J., concurring) ("'Set aside' means vacate, according to the dictionaries and the common understanding of judges, to whom the provision is addressed. And 'shall' means 'must.' I see no play in the joints."); *Milk Train, Inc. v. Veneman*, 310 F.3d 747, 757-58 (D.C. Cir. 2002) (Sentelle, J., dissenting).

The Ninth Circuit has adopted the same interpretation of Section 706, refusing to set aside unlawful agency action for equitable reasons. *See, e.g., Idaho Farm Bureau Fed'n v. Babbitt*, 58 F.3d 1392, 1405 (9th Cir. 1995) ("Ordinarily when a regulation is not promulgated in compliance with the APA, the regulation is invalid. However, when equity demands, the regulation can be left in place while the agency follows the necessary procedures.") (citation

omitted); *W. Oil and Gas Ass'n v. EPA*, 633 F.2d 803, 813 (9th Cir. 1980).[16]

The Third Circuit followed suit in this case. Although the court vacated the unlawfully promulgated rules, it made clear that it did not do so under the compulsion of the mandatory language of Section 706, but rather, because it viewed vacatur as the most appropriate remedy. *See* Pet. App. 49a n.13 (declining to exercise any discretion court might have to refuse vacatur). At the same time, the panel refused to "exercise [its] equitable authority to rescind" the auctions conducted pursuant to the unlawful rules, *id.* at 47a, because it considered that result "imprudent and unfair," *id.* at 49a, and not in "the public interest." *Id.* at 48a. Accordingly, while the court of appeals found no need to decide whether it had discretion to refuse to vacate the *rules*, it did not hesitate to treat the proper remedy for the unlawful auctions as a matter of discretion, consistent with the law in the Ninth and D.C. Circuits.

2. That assertion of discretionary authority has been squarely rejected by the Tenth Circuit. In *Forest Guardians v. Babbitt*, 174 F.3d 1178 (10th Cir.

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[16] The First, Fifth, and Federal Circuits have taken a more limited, phased approach, holding in certain cases that courts have discretion to remand a case to an agency for a fuller explanation of the agency's rationale, without deciding whether the agency action was unlawful, or vacating the agency action pending further proceedings on remand. *See, e.g., Cent. Me. Power Co. v. FERC*, 252 F.3d 34, 48 (1st Cir. 2001); *Cent. & S. W. Servs., Inc. v. EPA*, 220 F.3d 683, 692 (5th Cir. 2000); *Nat'l Org. of Veterans' Advocates, Inc. v. Sec'y of Veterans Affairs*, 260 F.3d 1365, 1380 (Fed. Cir. 2001).

1999), the Tenth Circuit was faced with the Department of the Interior's decision to unlawfully withhold, beyond an expired statutory deadline, a determination on the critical habitat of an endangered species. The court acknowledged that the D.C. Circuit had, in similar circumstances, concluded that relief "'does not necessarily follow a finding of a violation,'" but rather called for the exercise of remedial discretion. *Id.* at 1191 (quoting *In re Barr Labs., Inc.*, 930 F.2d 72, 74 (D.C. Cir. 1991)). The Tenth Circuit, however, rejected that conclusion:

> In light of the clear command of § 706, *we cannot agree*. Section 706 requires that a reviewing court 'shall compel agency action . . . unreasonably delayed,' and despite the *In re Barr* court's contrary conclusion, we believe that once a court deems agency delay unreasonable, it *must compel* agency action.

174 F.3d at 1191 (emphasis added).

The Federal Circuit has expressed the same understanding. In *PGBA, LLC v. United States*, 389 F.3d 1219 (Fed. Cir. 2004), the court contrasted the discretionary remedial standard created by the text of the Administrative Dispute Resolution Act of 1996 ("ADRA"), 28 U.S.C. § 1491(b)(2) (providing that "the courts *may* award any relief the court considers proper") (emphasis added), with the mandatory requirement of Section 706. 389 F.3d at 1224. The plaintiff in *PGBA* argued that, because the ADRA requires courts to review agency contracting decisions "pursuant to the standards set forth in section 706," 28 U.S.C. § 1491(b)(4), and because Section 706

leaves courts no "discretion to decide whether to set aside arbitrary and capricious government action," the ADRA likewise requires courts to set aside any contracting decision found to be unlawful. 389 F.3d at 1225. The Federal Circuit did not question that the plaintiff's construction of Section 706 was correct. Instead, it proceeded on the premise that if Section 706's remedial standards applied under the ADRA, unlawful contracting decisions must be set aside, and asked solely whether the ADRA's reference to Section 706 "merely incorporates the arbitrary and capricious standard of review from Section 706(2)(A), or whether it means that the reviewing court must set aside any action it finds arbitrary or capricious without consideration of the relative harms of such action." *Id.* [17]

At the same time, other courts, including this Court, have continued the tradition of vacating unlawful agency action as a matter of course, without directly addressing the question of discretion. *See AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 392 (1999) ("Because the Commission has not interpreted the terms of the statute in a reasonable fashion, we *must vacate* 47 CFR § 51.319 (1997).") (emphasis added); *Nat'l Ass'n of State Util. Consumer Advocates v. FCC*, 457 F.3d 1238, 1257-58 (11th Cir. 2006); *Ohio River Valley Envtl. Coalition v. Kempthorne*, 473 F.3d 94, 99, 104 (4th Cir. 2006); *Waterkeeper Alliance, Inc. v. EPA*, 399 F.3d 486, 524 (2d Cir. 2005); *Wall v. EPA*, 265 F.3d 426, 427 (6th Cir. 2001);

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[17] The court ultimately concluded that Congress imported only Section 706's "arbitrary and capricious" standard of review into the ADRA, leaving remedies to be controlled by the ADRA's own broader remedial provision. *See* 389 F.3d at 1226.

Iowa Utils. Bd. v. FCC, 120 F.3d 753, 801 (8th Cir. 1997), *aff'd in part and rev'd in part on other grounds sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999).

3. The conflict among the circuits is mature and entrenched, incapable of resolution except by this Court. In *Forest Guardians*, the Tenth Circuit acknowledged, but rejected, the contrary authority of the D.C. Circuit, 174 F.3d at 1190-91, and denied a petition for rehearing en banc to reconsider that decision. *Id.* at 1180. The D.C. Circuit likewise has persisted in its interpretation of the APA, despite repeated objections from its own judges, *see supra* pp. 17-18, and the contrary authority in the Tenth Circuit. *See Cobell v. Norton*, 240 F.3d 1081, 1096 n.4 (D.C. Cir. 2001) (noting, but disagreeing with, the Tenth Circuit's contrary position).

This conflict, and the broader uncertainty regarding the proper construction and application of the APA's remedial authority, should not be allowed to persist any longer. The APA was enacted to establish a uniform regime of judicial review of agency action. Its operation should not vary dramatically depending on whether the agency action is challenged in Denver or Dover. The present disuniformity invites forum shopping and unequal treatment of similarly situated individuals based on nothing more than accidents of geography, exactly what Congress intended to prevent by establishing a single, national standard in Section 706.

This case presents an ideal vehicle for resolving this dispute. The conflict in the circuits' interpretation of Section 706 is squarely presented by

the facts of this case and is outcome determinative. Here, the Third Circuit conducted a painstaking and careful review of the administrative record and found the agency's actions clearly unlawful. *See* Pet. App. 33a-46a. The only remedial question was whether that unlawful action should be set aside in whole, in part, or not at all. The court acknowledged petitioners' argument that "the APA requires us to 'hold unlawful *and set aside*' any such agency action," *id.* at 49a n.13 (emphasis in original) (citations omitted), as well as the FCC's defense of the D.C. Circuit's remand without vacatur jurisprudence. *Id.* at 49a. And the choice between those competing constructions of the statute determined the outcome of petitioners' challenge to the unlawfully conducted auctions in this case.

B. Whether Section 706 Permits Courts To Decline To Set Aside Unlawful Agency Action Is A Question Of Recurring Importance, With Profound Implications For The Nation's Telecommunications Policy As Applied In This Case.

Certiorari is further warranted because the proper interpretation of the APA's remedial provision is a frequently recurring question of enduring national importance. The court of appeals' misapplication of Section 706 to this case, moreover, has broad and damaging consequences for the implementation of the nation's telecommunications policy.

1. The scope of courts' remedial discretion under the APA is a question relevant to the disposition of thousands of APA suits arising in a multitude of

contexts. What had historically been a simple remedial matter for reviewing courts, namely to set aside all unlawful agency action, is currently plagued by uncertainty and confusion. In the absence of guidance from this Court, lower courts have been left to grapple with the glaring conflict between the mandatory plain language of Section 706 and departures from that language in certain circuits, including now the Third.

The present uncertainty stands as a deterrent to challenges to even the most blatant agency violations. As things now stand, even those litigants with the resolve and resources to challenge agency action they believe to be unlawful must weigh the substantial costs of a challenge against highly uncertain benefits, where remedial discretion may effectively deny them meaningful relief.

At the same time, the prevalence of doctrines like "remand without vacatur" in some circuits reduces agencies' incentives to adhere carefully to the procedural requirements of the APA, knowing that there is a real chance that if a court finds the agency's conduct unlawful, it will nonetheless decline to set the action aside. It takes little imagination to conclude, for example, that if the FCC knew that licensing auctions conducted pursuant to unlawful rules would ultimately be "set aside" by a reviewing court, the rules vacated in this case would never have

seen the light of day.[18] As noted above, p. 9, at the time of adoption of the Vacated Rules, FCC Commissioner Adelstein was acutely aware that the FCC's actions in the "troubled proceeding" that produced those rules could eventually lead to an overturn of then pending Auction 66. Future FCC Commissioners, faced only with the prospect of the vacatur of unlawfully adopted rules far down the judicial road, with agency "licenses" issued under those unlawful rules insulated by equitable considerations, would have no reason to treat seriously Commissioner Adelstein's concern.

2. The court of appeals' misapplication of Section 706 particularly warrants review in this case because of its detrimental effects on the nation's telecommunications policy. The unlawful agency action in this case directly and substantially harmed small business participation in two of the most important spectrum licensing auctions in the history of this country, encompassing vital nationwide, regional, and local licenses that govern the use of vast amounts of very valuable spectrum.[19] In the

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[18] *See* Daniel B. Rodriguez, *Of Gift Horses and Great Expectations: Remands Without Vacatur in Administrative Law*, 36 Ariz. St. L.J. 599, 620 (2004) ("[T]here are good reasons to suppose that an agency will be motivated both *ex ante* and *ex post* to adopt rules in a manner that will pass muster if they know that they face the prospect of vacatur if they fail.").

[19] Commissioner Adelstein aptly characterized Auction 66 as the agency's "most significant auction in 10 years," CA-JA 168, and referred to the spectrum made available in Auction 73 as "the finest crown jewels the FCC has to put up for auction." *Second Report and Order*, WT Docket No. 06-150, 22 F.C.C.R. 15289, 15564 (2007).

absence of effective judicial relief, the damage to the public in the form of further entrenchment of incumbents and the loss of benefits, including the lower costs and greater innovation produced by competition, will be deep and irreparable. Such auctions are few and far between, and the licenses confirmed by the Third Circuit here will remain in the hands of large incumbents for the foreseeable future.[20]

C. The Plain Language Of Section 706 Deprives Courts Of Any Equitable Discretion To Refuse To Set Aside Unlawful Agency Action.

The decision below should also be reviewed by this Court because, under the plain language of the statute and this Court's precedents, Section 706 allows reviewing courts no discretion to refuse to set aside unlawful agency action.

Section 706 states in plain and unambiguous terms that courts "shall . . . set aside" actions taken by agencies in violation of the APA. 5 U.S.C. § 706(2)(A) (2006). Numerous decisions of this Court have made clear that "shall" means "shall" (not "may") and leaves no room for the exercise of discretion. *See, e.g., Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 661 (2007) (language in the Clean Water Act, providing that the EPA "shall approve" an application seeking to transfer permitting authority from the EPA to a state unless the EPA finds the state cannot perform nine

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[20] *See, e.g.*, 47 C.F.R. § 27.13 (setting ten-year license term) and 47 C.F.R. § 27.14 (setting criteria for renewal).

functions listed in the statute, "is mandatory and the list exclusive; if the nine specified criteria are satisfied, the EPA *does not have the discretion* to deny a transfer application") (emphasis added); *Lopez v. Davis*, 531 U.S. 230, 241 (2001) (noting Congress' "use of a mandatory 'shall' . . . to impose *discretionless* obligations") (emphasis added); *Lexecon, Inc. v. Milberg Weiss Bershad Hynes & Lerach*, 523 U.S. 26, 35 (1998) ("the mandatory 'shall' . . . normally creates an obligation *impervious to judicial discretion*") (emphasis added).

Indeed, this Court need look no further than the immediately preceding section of the APA for confirmation that Congress uses "may" when it wants to grant permissive authority to an agency or reviewing court. Section 705 states that an agency "*may* postpone the effective date of action taken by it" and a reviewing court "*may* issue all necessary and appropriate process to postpone" such an effective date. 5 U.S.C. § 705 (emphasis added).

Consistent with the APA's plain meaning, this Court has consistently observed that the remedy established by Section 706 is mandatory. In *Federal Power Commission v. Transcontinental Gas Pipe Line Corp.*, this Court made clear that "[i]f the . . . decision of the agency 'is not sustainable on the administrative record made, then the . . . decision *must* be vacated and the matter remanded . . . for further consideration.'" 423 U.S. 326, 331 (1976) (*quoting Camp v. Pitts*, 411 U.S. 138, 143 (1973) (emphasis added)). To a similar effect is the seminal administrative law case *Citizens to Preserve Overton Park v. Volpe*, which stated that "in *all* cases agency action *must* be set aside if the action was 'arbitrary,

capricious, an abuse of discretion, or otherwise not in accordance with law' or if the action failed to meet statutory, procedural, or constitutional requirements." 401 U.S. 402, 413-14 (1971) (citing Section 706(2)(A-D)) (emphasis added); *see also AT&T Corp. v. Iowa Utils. Bd.*, *supra* p. 21, 525 U.S. at 392.

This does not mean that every minor flaw in an agency's administration of its duties requires courts to set aside the resulting rule or other action. The final clause of Section 706 specifically provides that "due account shall be taken of the rule of prejudicial error." 5 U.S.C. § 706 (2006). But where, as here, unlawful agency action has clearly prejudiced a party,[21] Congress has itself determined that the appropriate remedy is to set aside the agency action, leaving no room for any court to reach the contrary judgment.

II. The Third Circuit's Decision To Deny Any Relief At All Independently Warrants Review.

Certiorari is further warranted to decide whether, even if Section 706 permits equitable

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[21] The court below did not find that the agency's violation of notice and comment, or its conduct of the auctions pursuant to the unlawfully issued rules, was non-prejudicial. Nor could it. Rather, the court recognized that the errors were "serious." Pet. App. 50a. Those violations substantially harmed DEs by driving away funding sources through the sudden imposition of a ten-year exit horizon, unacceptable on its face for rational investors in a dynamic, fast-paced industry, and devastating business plans by substituting the rigid 50 Percent Rule for the well established and essential flexibility provided by wholesaling/leasing models.

discretion to decline to set aside unlawful agency action, the statute nonetheless requires the reviewing court to provide an alternative available remedy, which the Third Circuit declined to do in this case, placing it in conflict with the decisions of other courts.

A. The Third Circuit's Denial Of Any Relief At All Conflicts With The Law Of The D.C. Circuit And The Decisions Of This Court.

The Third Circuit did not question that the auctions in this case – conducted pursuant to unlawfully issued rules – constituted unlawful agency action subject to Section 706's "shall . . . set aside" command.[22] The court of appeals nonetheless not only refused to "set aside" the auction results, but declined to provide any remedy at all to petitioners injured by the unlawful agency action. The court did so despite the FCC's and the intervenors' acknowledgement that in prior similar cases, the D.C. Circuit had required the Commission to provide alternative remedies when that Circuit had refused to vacate the results of similar unlawful agency action. *See supra* p. 13. The holding in this case is incompatible with those decisions, the text and purposes of the APA, and the decisions of this Court.

1. The D.C. Circuit has recognized that a party who "makes out its case under the APA is *entitled to remedy*." *Am. Bioscience Inc. v. Thompson*, 269 F.3d

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[22] An agency's award of a "license" pursuant to an auction, like an agency's adoption of a "rule," is "agency action" under 5 U.S.C. § 551(13).

1077, 1084 (D.C. Cir. 2001) (emphasis added). Thus, in other cases involving FCC action found unlawful under the APA, the D.C. Circuit has required the Commission to provide alternative remedies, even when the court has declined to set aside the unlawful agency action directly.

For example, in *City of Brookings Municipal Telephone Company v. FCC*, *supra* p. 13, the D.C. Circuit held that the FCC acted arbitrarily and capriciously in changing the settlement process for allocating revenue among carriers for interstate telephone calls. The changes had been implemented, and had been used to divide revenue among carriers for some time by the date the D.C. Circuit rendered its decision. The Court therefore declined to "order[] the reassessment of settlement payments made under" the invalid rules, because doing so would "disrupt the settlement process" and "cause economic hardship" for some companies. 822 F.2d at 1171. However, that did not lead the court to hold that no relief should be afforded those injured by the unlawful rules. Instead, the court ordered the FCC to decide "how best to accommodate these various interests in light of the proceedings on remand." *Id.* at 1172.

The D.C. Circuit reached the same conclusion in *Freeman Engineering Associates v. FCC*, *supra* p. 13. There, the court considered the FCC's system of distributing radio spectrum. At the time, the FCC provided a "pioneer's preference" for companies developing innovative services. 103 F.3d at 174. The D.C. Circuit held that the Commission had arbitrarily and capriciously applied its pioneer preference rules to deny Qualcomm a preference, and

remanded to the FCC "for further proceedings to remedy" the violation. *Id.* at 180. While the case was on remand, Congress amended the relevant legislation, leading the Commission to believe that it was required to deny Qualcomm a preference. The Commission subsequently auctioned off some of the spectrum Qualcomm had sought to another company, Sprint. When Qualcomm appealed, the D.C. Circuit held that the Commission had misconstrued the intervening legislation and violated the court's prior mandate in declining to grant Qualcomm spectrum in accordance with the preference to which it was entitled. *Qualcomm, Inc. v. FCC*, 181 F.3d 1370, 1376 (D.C. Cir. 1999). Although the Court did not order the FCC to vacate the auction of spectrum to Sprint, it did not – as the Third Circuit did here – conclude that Qualcomm was entitled to no relief at all for its injuries. Instead, the D.C. Circuit ordered the FCC to provide an alternative remedy, requiring it to "take prompt action to identify a suitable spectrum and award QUALCOMM the license for it." *Id.* at 1381. The Commission subsequently granted Qualcomm a transferable Auction Discount Voucher to be used in any spectrum licensing auction over a three-year period. *QUALCOMM, Inc.*, 16 F.C.C.R. 4042 (2000).

The D.C. Circuit is not alone in its view that the APA requires at least *some* kind of remedy for unlawful agency action. *See Andrx Pharm. Inc. v. Biovail Corp.*, 276 F.3d 1368, 1379 (Fed. Cir. 2002) (holding that a party that "prevails under its APA claim . . . is *entitled to a remedy* under the statute, which normally will be a vacatur of the agency's order") (emphasis added).

2. The Third Circuit's total denial of any auction-related remedy is also in conflict with the text and purposes of the APA. Refusing to provide any relief at all is the precise opposite of "set[ting] aside" unlawful agency action, 5 U.S.C. § 706(2)(A). The APA was specifically designed "to afford parties affected by administrative powers a means of knowing what their rights are, and how they may be protected," and to assure those affected parties "judicial review designed to afford *a remedy* for *every* legal wrong." 92 Cong. Rec. 2151 (1946), *reprinted in* Administrative Procedure Act, Legislative History, S. Doc. No. 79-248, at 304 (1946) (statement of Sen. Pat McCarran) (emphasis added). This guarantee of a judicial remedy, in the event of agency violation of a private right, is one of the "minimum basic essentials" set forth by the APA. *Id.*

Congress thus fully intended the APA to follow the basic American legal tenet that the law provides a remedy for every violation of a legal right. In the same year the APA was enacted, this Court reaffirmed the established principle that "where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief." *Bell v. Hood*, 327 U.S. 678, 684 (1946). That fundamental principle found voice in this Court as long ago as *Marbury v. Madison*, 5 U.S. 137, 163 (1803): "The government of the United States has been emphatically termed a government of laws, and not of men. It will certainly cease to deserve this high appellation, if the laws furnish no remedy for the violation of a vested legal right." And this Court has consistently adhered to it ever since.

See, e.g., De Lima v. Bidwell, 182 U.S. 1, 176-77 (1901) ("If there be an admitted wrong, the courts will look far to supply an adequate remedy."); *Franklin v. Gwinnett Co. Pub. Sch.*, 503 U.S. 60, 66 (1992) ("From the earliest years of the Republic, the Court has recognized the power of the Judiciary to award appropriate remedies to redress injuries actionable in federal court . . . .").

B. Whether Courts Have Authority To Deny All Relief For APA Violations Is A Question Of Recurring Importance That Warrants This Court's Review.

The scope of any remedial discretion under Section 706 – like the availability of any discretion at all – is a recurring question that affects virtually every suit under the APA. The absence of guidance from this Court in this area has led to arbitrary differences in treatment and undermined the basic remedial purposes of the statute.

This case compellingly illustrates how, in the absence of guidance from this Court, the former rule that unlawful agency action must be set aside has in certain cases been replaced by nearly the opposite presumption that relief is to be severely limited or denied altogether if an agency violation is either "too minor to matter"[23] or, as here, "too big to fail." This "Goldilocks" approach led to the denial in this case of all relief with respect to two licensing auctions of

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[23] *See, e.g., La. Fed. Land Bank Ass'n v. Farm Credit Admin.*, 336 F.3d 1075, 1085 (D.C. Cir. 2003) (remand without vacatur employed where the agency's "only error was its failure to explain what seems to be a policy difference with the plaintiffs").

highly valuable, publicly-owned electromagnetic spectrum that were conducted pursuant to unlawful, seriously deficient rules.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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December 22, 2010

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 08-2036

COUNCIL TREE COMMUNICATIONS, INC., BETHEL NATIVE CORPORATION, and THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,

Respondents.

On Petition for Review of Orders of the Federal Communications Commission

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DECIDED: August 24, 2010

Before FISHER, HARDIMAN and STAPLETON, Circuit Judges

COUNCIL TREE COMMUNICATIONS, INC.; BETHEL NATIVE CORPORATION; THE MINORITY MEDIA AND TELECOMMUNICATIONS COUNCIL, Petitioners v. FEDERAL COMMUNICATIONS COMMISSION; UNITED STATES OF AMERICA, Respondents, CTIA-WIRELESS Association and T-Mobile USA, Inc., Intervenor Respondents (Per Clerk Order of 4/28/08), CELLCO PARTNERSHIP d/b/a Verizon Wireless, Intervenor Respondent (Per Court Order of 6/30/08)

No. 08-2036

UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

HARDIMAN, *Circuit Judge.*

This dispute comes to us for the fourth time. At issue is a challenge to some of the rules that governed the participation of small wireless telephone service providers in auctions of electromagnetic spectrum conducted by the Federal Communications Commission (FCC or the Commission).

The FCC is authorized to grant licenses for the use of bands of the electromagnetic spectrum and has done so chiefly through auctions for defined geographic markets. Because the law requires the FCC to promote the participation of small businesses in the use of the spectrum, it has defined a class of

designated entities (DEs) which are eligible for bidding credits. These credits are added to the dollar amount of the DEs' bids, to make it easier for them to win spectrum licenses at auction.

The petitioners here are (1) Council Tree Communications, an investor in DEs; (2) Bethel Native Corporation, a small wireless carrier based in Alaska whose stock is owned by Alaskan natives; and (3) the Minority Media and Telecommunications Council (MMTC), a trade group representing minority-owned telecom companies. Petitioners seek review of multiple orders in an FCC rulemaking entitled *In re Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures*, WT Docket No. 05-211, in which the FCC changed the qualifications for DE status as well as the restitution that must be made by a licensee that loses DE status after taking advantage of bidding credits. Petitioners claim that these rules (1) were enacted without the notice and opportunity for comment required by the Administrative Procedure Act (APA), and (2) are arbitrary and capricious, in violation of the APA. Petitioners ask us to rescind the results of approximately $ 33 billion worth of auctions held under the challenged rules, and to order the FCC to conduct new auctions under new rules.

I.

A. Legal Background

Although the FCC possesses broad authority to auction licenses to use portions of the electromagnetic spectrum, it must promote "economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses [and] rural telephone companies." 47 U.S.C. § 309(j)(3)(B). The FCC must also "ensure that small businesses [and] rural telephone companies . . . are given the opportunity to participate in the provision of spectrum-based services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures." *Id.* § 309(j)(4)(D).

Consistent with these statutory mandates, in conducting spectrum auctions the FCC offers bidding credits that increase the bids of small entities, in an amount measured as a percentage of the entities' initial bids. After a DE submits its bid, this credit is added to the bid for purposes of determining the winner of the auction. If the DE wins the auction, however, it will be required to pay only the amount of its initial bid, not the amount that includes the credit. The credits are available as follows: (1) a 15% credit for entities averaging annual gross revenues of $ 40 million or less over the last three years; (2) a 25% credit for entities averaging annual gross revenues of $ 15 million or less over the last three years; and (3) a 35% credit for entities averaging $ 3

million or less in average revenues over the last three years. 47 C.F.R. § 1.2110(f)(2)(i) to (iii). Although the FCC defines the term "designated entities" to mean "small businesses" generally, *see id.* § 1.2110(a), the term is relevant here only insofar as it refers to bidders who qualify for these credits.

The bidding-credit system could be abused by small companies willing to immediately monetize their bidding credits by selling their spectrum licenses at market prices, or by large companies taking advantage of credits through affiliates or puppet corporations that technically qualify as DEs. To prevent this, the FCC is required to seek the "avoidance of unjust enrichment through the methods employed to award" spectrum licenses, 47 U.S.C. § 309(j)(3)(C), and to establish "such . . . antitrafficking restrictions and payment schedules as may be necessary to prevent unjust enrichment as a result of the methods employed to issue licenses and permits." *Id.* § 309(j)(4)(E). In the rulemaking at issue here, the FCC adopted three regulations of this type.

First, to prevent subsidiaries or affiliates of large businesses from qualifying for DE credits, 47 C.F.R. § 1.2110(b)(1)(i) provides that:

> [t]he gross revenues of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or licensee) and considered on a cumulative basis and aggregated for purposes of determining

> whether the applicant (or licensee) is eligible for status as a small business[.]

Insofar as it applies to an applicant's affiliates and controlling interests, and the affiliates of an applicant's controlling interests, this revenue attribution rule is long-standing and is not contested here. Instead, in the challenged rulemaking the FCC imposed revenue attribution for "entities with which [the applicant or licensee] has an attributable material relationship," and defined the phrase "attributable material relationship." That definition appears in 47 C.F.R. § 1.2110(b)(3)(iv)(B) and states:

> [a]n applicant or licensee has an attributable material relationship when it has one or more arrangements with any individual entity for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

The second challenged regulation is 47 C.F.R. § 1.2110(b)(3)(iv)(A), which was promulgated for the first time in the rulemaking at issue here and provides:

> [a]n applicant or licensee that would otherwise be eligible for designated entity benefits under this section and applicable service-specific rules shall be ineligible for such benefits if the applicant or licensee has an impermissible material relationship. An applicant or licensee has an impermissible material relationship when it has

> arrangements with one or more entities for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 50 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

Thus, unlike an "attributable material relationship," a business that has an *impermissible* material relationship is *ipso facto* disqualified from receiving bidding credits.

Third, the FCC has recognized that unjust enrichment will occur if recipients of bidding credits are permitted to promptly sell their spectrum rights to non-DEs at a premium, or to ally themselves with large entities in such a way as to lose their DE status. To prevent this, 47 C.F.R. § 1.2111(d)(1) states:

> [a] licensee that utilizes a bidding credit, and that during the initial term seeks to assign or transfer control of a license to an entity that does not meet the eligibility criteria for a bidding credit, will be required to reimburse the U.S. Government for the amount of the bidding credit, plus interest . . . as a condition of Commission approval of the assignment or transfer. . . . If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to make any ownership change or to enter into a material relationship (see § 1.2110) that would result in the licensee losing eligibility for a bidding credit . . . the amount of the bidding credit . . . plus interest . . . must be paid to the U.S.

> Government as a condition of Commission approval of the assignment or transfer . . . .

If a DE licensee takes action that does not render it wholly ineligible for a bidding credit, but leaves it eligible only for a smaller credit than the one it used to acquire a license, the difference in value between the two credits must be repaid. *Id.*

This repayment obligation existed before the rulemaking challenged by Petitioners here. At issue in this petition is the length of time after a DE wins a license using a bidding credit that it is subject to the repayment requirement. Although the most effective method to prevent misuse of bidding credits would be to require that a DE winning a license with such credits both maintain its DE status and hold the license until it expired, it appears that the FCC has long applied a more lenient rule in order to permit DEs to participate in the secondary market for spectrum rights, and to allow DEs to attract investment capital that might be hard to obtain if there were no way for DEs to liquidate such a valuable asset. Accordingly, FCC regulations provide for a reduction in the repayment amount if the DE's offending action does not occur until an appreciable time after it won the license. In the rulemaking at issue here, the FCC extended the time period over which the repayment obligation applies. Before the rulemaking, 47 C.F.R. § 1.2111(d)(2)(i) provided that the required repayment dropped to 75% of the bidding credit value for license transfers or losses of DE status occurring up to two years after the auction, 50% of the credit for those occurring during the third year after the auction, 25% of the

credit during the fourth year, and zero after five years. *Id.* (effective through June 6, 2006). The instant rulemaking amended § 1.2111(d)(2)(i) to require full repayment of the credit if eligibility is lost in the first five years after the auction, 75% repayment if eligibility is lost in the sixth or seventh year, 50% if eligibility is lost in the eighth or ninth year, 25% in the tenth year, and eliminated the penalty only after ten years.

B. The Rulemaking Proceeding

1. The Further Notice of Proposed Rulemaking

On February 3, 2006, the FCC issued a Further Notice of Proposed Rulemaking *In re Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures*, 21 F.C.C.R. 1753 (2006) (hereinafter FNPR). The FNPR was a response to an *ex parte* letter from Council Tree Communications (Council Tree), the lead petitioner here. In the FNPR, the FCC agreed with Council Tree's view "that the Commission's current rules do not adequately prevent large corporations from structuring relationships in a manner that allows them to gain access to benefits reserved for small businesses." *Id.* at 1759-60. Therefore, the FNPR sought "comment on the elements of a proposal raised by Council Tree . . . that seeks to prohibit the award of bidding credits or other small business benefits to entities that have what Council Tree refers to as a 'material relationship' with a 'large in-region incumbent wireless service provider.'" *Id.* at 1754 (footnotes

omitted). The FCC "tentatively conclude[d]" that such regulations were appropriate, *id.* at 1757, and "s[ought] comment on how [it] should define the elements of such a restriction," *id.* at 1755, as well as "on whether [it] should [also] restrict the award of designated entity benefits where an otherwise qualified designated entity has a 'material relationship' with a large entity that has a significant interest in communications services," *id.*

Throughout the FNPR, the FCC reiterated these requests for comments in similar or identical terms. *See id., passim.* It also solicited comments in more specific terms on possible variations on each of the elements proposed by Council Tree. With respect to the definition of "material relationship," the FCC inquired whether its then-current rules requiring attribution of the revenues of an applicant's controlling interests and affiliates were sufficient to prevent improper influence by large businesses over small bidders. *Id.* at 1760-61. The FCC asked whether those attribution rules, or any new definition of "material relationship," should vary according to whether they were applied to "large, in-region, incumbent wireless service providers" or "entit[ies] with significant interests in communications services." *Id.* at 1760. Of particular note here, the FCC

> s[ought] comment on what, if any, standard should be used to determine whether a spectrum leasing arrangement is a 'material relationship' for the purpose of any additional restriction on the availability of designated entity benefits that we might adopt. We also

> seek comment on whether other arrangements should be taken into account. If so, what arrangements should we consider?

Id. at 1761.

With respect to the definition of "large, in-region, incumbent wireless service provider," the FCC sought comment on how much geographic overlap between the incumbent's and DE's service areas should be required for the "in-region" criterion to be met, *id.* at 1759, 1762, and whether gross revenues were the appropriate metric for determining whether the incumbent was "large," and, if so, what the proper cutoff would be. *Id.* at 1759, 1761-62. With respect to the phrase "entity with significant interests in communications services," the FCC inquired how "large" status should be determined, *id.* at 1761-62, whether an "in-region" geographical element should also apply, *id.* at 1762, and how broadly the phrase "significant interests in communications services" should be defined, and what kinds of entities it should encompass, *id.* at 1762-63.

The FNPR also sought comment

> on whether, if we adopt a new restriction on the award of bidding credits to designated entities, we should adopt revisions to our unjust enrichment rules such as those proposed by Council Tree, or in some other manner. . . . If we require reimbursement by licensees that, either through a change of 'material relationships' or assignment or transfer of control of the license, lose their

> eligibility for a bidding credit pursuant to any eligibility restriction that we might adopt, over what portion of the license term should such unjust enrichment provisions apply?

Id. at 1763. The FCC also explicitly requested comment on whether the proposed restrictions risked unduly limiting DEs' ability to raise capital. *Id.* at 1761.

Finally, the FCC confirmed in the FNPR that it expected "to complete this proceeding in time so that any modifications to our rules resulting from this proceeding will apply to the upcoming auction of licenses for Advanced Wireless Services ('AWS'), which currently is scheduled to begin June 29, 2006," which was less than four months after the release of the FNPR. *Id.* at 1755, 1763. This auction – known as "Auction 66" – was the largest spectrum auction in several years. To achieve this goal, the comment period on the FNPR ran for only 14 days after its publication in the Federal Register, and the reply comment period lasted only one week thereafter. *Id.* at 1753.

2. Comments on the FNPR

Despite the brief time frame, a number of comments on the FNPR were submitted. Most commenters supported some changes along the lines suggested by the FNPR. A representative comment in this regard came from the Department of Justice, which reported that it had

> found contractual or other arrangements between DEs and large wireless carriers that

> created such close ties between the two that the DEs could not be considered to be truly independent competitive actors; in some of these instances, the DE affiliated with a large wireless carrier had not launched commercial services to end-user customers or other wireless carriers but only provided roaming services to its large affiliate.

J.A. 1052-53. In light of this finding, the DOJ recommended that such a relationship disqualify the DE, but suggested that lower-level relationships, such as "arm's-length negotiated agreements for roaming or brand licensing and support," *id.* at 1054, would not necessarily be problematic. In sum, the DOJ maintained that "[a] relationship where the large enterprise dominates the DE is troubling as it suggests that the DE is not within the class of entities (i.e., small businesses) that the FCC's rules are designed to benefit." *Id.*

Several comments addressed the application of the proposed rules to spectrum leases by DEs to non-DEs. Council Tree agreed that the suspect class of arrangements should include leasing arrangements, J.A. 439, arguing that such "agreements . . . convey a level of influence over the operations of the designated entity that is inappropriate in the hands of a dominant national wireless service provider," *id.* at 439-40. The NTCH, Inc. proposed that DEs should be able to lease spectrum freely, so long as substantial portions of spectrum in the same geographic area remained in use by DEs. J.A. 663-64. Wirefree Partners argued against any further

restrictions on leasing by DEs, J.A. 759-60, but Council Tree disagreed, J.A. 873-74.

Several commenters also argued that the proposed categories of "large, in-region, incumbent wireless service providers" or "large entities with significant interests in communications services" were too narrow. These commenters argued repeatedly that the statutory objective of assisting small businesses would be frustrated by a bidder's material relationship with a large business of *any* kind, regardless of whether the large business was involved in the communications industry. *See* Comments of CTIA – The Wireless Association, J.A. 510, 518 ("the *Notice* makes no attempt to justify a distinction between large incumbent carriers and any other class of non-attributable investor," such as AOL, Google, or Microsoft, but the problems arising from large investors' dominance of DEs "would presumably run to all potential investors, not just large carrier partners"); Comments of Dobson Comm'ns Corp., J.A. 526 (urging the FCC to apply any changes to "any large, well-funded investor with a strategic interest in the use of the spectrum"); Comments of T-Mobile USA, Inc., J.A. 697 ("[t]here does not appear to be a justification for permitting Microsoft or Wal-Mart to participate in a DE joint venture while precluding T-Mobile from doing so."); *see also* Comments of Verizon Wireless, J.A. 745; Comments of Wirefree Partners III, LLC, J.A. 760; Reply Comments of T-Mobile USA, Inc., J.A. 812; Reply Comments of Cingular Wireless LLC, J.A. 833-34.

3. The Second Report and Order and Second Further Notice of Proposed Rulemaking

After receipt of the aforementioned comments, on April 25, 2006, the FCC adopted and released its Second Report and Order and Second Further Notice of Proposed Rulemaking (Second R&O), 21 F.C.C.R. 4753 (2006).[1] Therein, the FCC stated its "particular intention . . . to ensure that entities ineligible for designated entity incentives cannot circumvent our rules by obtaining those benefits indirectly, through their relationships with eligible entities." *Id.* at 4754. The FCC acknowledged that

> [t]he challenge for the Commission in carrying out Congress's plan has always been to find a reasonable balance between the competing goals of, first, providing designated entities with reasonable flexibility in being able to obtain needed financing from investors and, second, ensuring that the rules effectively prevent entities ineligible for designated entity benefits from circumventing the intent of the rules by obtaining those benefits indirectly, through their investments in qualified businesses.

Id. at 4756 (footnote omitted). To this end, the FCC "agree[d] with commenters that certain agreements have the potential to significantly influence a designated entity licensee's decisions regarding its provision of service and, therefore, also have the potential to be abused, absent the appropriate

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[1] The first Report and Order is not directly relevant here.

safeguards." *Id.* at 4762. In an attempt to create such safeguards, and as we described herein, the Second R&O established revenue attribution for "attributable material relationships," defined as the lease of more than 25% of the DE's spectrum capacity by any single lessee, and mandated the loss of DE status by any licensee that acquires an "impermissible material relationship," by leasing an aggregate of more than 50% of its spectrum capacity. *Id.* at 4763-64.

Notably, neither the 25% rule nor the 50% rule applied only to relationships with large entities. This, said the Second R&O, was because the FCC had

> conclude[d] that certain agreements, by their very nature, are generally inconsistent with an applicant's or licensee's ability to achieve or maintain designated entity eligibility because they are inconsistent with Congress's legislative intent. In this regard, where an agreement concerns the actual use of the designated entity's spectrum capacity, it is the agreement, as opposed to the party with whom it is entered into, that causes the relationship to be ripe for abuse and creates the potential for the relationship to impede a designated entity's ability to become a facilities-based provider, as intended by Congress.

Id. at 4762.

The legislative intent referenced is that behind 47 U.S.C. § 309(j)(4)(C), the authorization for the

FCC's promulgation of antitrafficking and anti-unjust enrichment provisions. The House of Representatives Budget Committee's report on this provision explicitly contemplated its use in connection with the promotion of small-business licenses, and stated that "[t]he Committee anticipates that the Commission will use this authority to deter speculation and participation in the licensing process by those who have no intention of offering service to the public." H.R. Rep. No. 103-111, at 257-58, *reprinted in* 1993 U.S.C.C.A.N. 378, 584-85. The Second R&O reiterated its reliance on this congressional intent several times. 21 F.C.C.R. at 4755, 4760, 4762-64, 4766.

The Second R&O also extended the bidding-credit-repayment schedule to 10 years. The extended obligation applies "if a designated entity loses its eligibility for a bidding credit for any reason, including but not limited to[] entering into an 'impermissible material relationship' or an 'attributable material relationship.'" *Id.* at 4766. The FCC again stated that "[b]y extending the unjust enrichment period to ten years, we increase the probability that the designated entity will develop to be a competitive facilities-based service provider." *Id.*

The Second R&O also included a Second Further Notice of Proposed Rulemaking, which sought additional comment on the elements of Council Tree's initial proposal, namely, whether the FCC should impose further restrictions on grants of DE status to applicants having other sorts of "material relationships" with large in-region incumbent

wireless providers. *Id.* at 4773-74 (seeking comment on the definition of "large" and whether relationships with non-wireless businesses should also be regulated); 4776-78 (seeking comment on propriety and definition of "in-region" criterion); 4779-84 (same, on definition of "material relationship"). The FCC noted its "concern[] that additional types of relationships could . . . allow[] an ineligible entity the ability to gain undue advantages in the communications marketplace through the benefits offered to a designated entity applicant," and asked, "[a]re the new rules we adopt today sufficient to safeguard against many of these concerns?" *Id.* at 4780.

The Commission further stated, however, that

> [w]e generally do not have the same concerns regarding relationships between designated entity applicants and those who do not have interests in spectrum capacity or the provision of service, such as financial institutions or venture capital firms, provided that such entities do not have a controlling interest relationship with the applicant.

Id. This, said the FCC, was because cross-industry investments did not present the investor an "opportunity for it to bundle existing communications services with a strategic wireless partner, and there is less potential for those entities to exert undue influence over a designated entity licensee's decision making regarding its service provision or the use of its licensed spectrum." *Id.*

4. Response to the Second R&O

The new rules promulgated in the Second R&O provoked criticism from some DEs and their investors. Several petitions for reconsideration were filed with the FCC, including one by the Petitioners here. Two of Petitioners' arguments for reconsideration before the FCC are relevant here. First, Petitioners maintained that "[n]one of the new rules is limited to arrangements involving large, in-region incumbent wireless service providers as contemplated in the *Further Notice of Proposed Rule Making*." Pet. for Exp. Reconsid'n, J.A. 1281. Second, Petitioners argued that the 10-year credit-repayment schedule "eviscerat[es] a designated entity's access to capital because lenders and investors who are being asked to back untested new entrants want to see that the designated entity has a clear path to exit if the business is not succeeding," *id.* at 1281-82, and that the FCC had failed to take this into account in setting the new rules.

Both of Petitioners' objections were supported by the views of a number of other commenters, most of whom contacted the FCC for the first time in response to the Second R&O. Catalyst Investors, LLC, which had provided capital for several DEs in the past and was planning to do so in connection with Auction 66, stated:

> both the equity and the debt markets will not be comfortable with the '10 Year Hold Rule,' as it is outside the normal hold periods for most sources of capital. Due to a lack of reasonable notice in the proceeding, the rule

> came as a surprise and was not the subject of any meaningful public input. Had such input been received, we strongly believe the Commission would have realized that the 10 year period is just too long.

Id. at 1243; *cf. Ex Parte* Presentation of The Eezinet Corp., et al., S.J.A. 91 (same arguments, by a group of DE financiers and DEs); Notice of *Ex Parte* Presentation of Cook Inlet Region, Inc., J.A.1487 (small carrier allied with T-Mobile commenting that "[n]o significant investor will be willing to risk its return on investment over a ten year horizon"); Letter from the Nat'l Telecomm'ns Coop. Ass'n, J.A. 1508-09 (industry group representing rural telecoms, complaining of a lack of public notice and the short time between the promulgation of the rules and Auction 66); *Ex Parte* Letter from Coral Wireless Licenses, LLC, et al., J.A. 1547-48 (another group of small businesses and their investors, commenting that "[a] business transaction where there is no clear path to liquidity for 10 years is a very unattractive investment for the financial institutions and venture capital firms that traditionally have supported wireless start-up ventures," and that they "did not understand from the *Further Notice* that changes of this nature were under consideration by the Commission or they would have commented on this issue"); Notice of Oral *Ex Parte* Presentation of Doyon, Ltd., J.A. 1550 (investor in small telecoms commenting that "the new ten year unjust enrichment schedule . . . makes it more difficult for designated entities to secure financing and find strategic partners because it is less likely that they can easily exit the business in the event of significant

changes in the industry"); Letter from Royal Street Comm'ns, LLC, J.A. 1557 ("[A] transaction where there is no clear path to liquidity, without penalty, for 10 years is a very unattractive investment for the types of financial institutions and venture capital firms that traditionally have supported wireless start-up ventures.").

Royal Street Communications LLC, a DE engaged in wireless wholesaling, objected that the new rules impacted arrangements by DEs with other small entities, as well as large ones. Letter from Royal Street Comm'ns, LLC, J.A. 1557. Royal Street claimed the new rules placed restrictions on wireless wholesaling

> without affording . . . DEs notice and the opportunity to comment. . . . [T]hese restrictions will also contribute to investor and financier reluctance to back wireless licenses that are effectively limited to a retail business model, a model decidedly more expensive and administratively burdensome. The Order's restrictions ignore the fact that wholesale services are a wireless product increasingly in demand . . . which can add to the competitive options in the wireless marketplace.

Id. at 1558. The Rural Telecommunications Group., Inc., also contended that "[t]he new material relationship rules are overbroad and unduly restrictive," because, "current DE licensees will be unable to . . . lease existing spectrum . . . to another DE without becoming ineligible for DE benefits in

the AWS auction." *Ex Parte* Letter from the Rural Telecomm'ns Group, Inc., J.A. 1542.

5. The Order on Reconsideration of the Second R&O

On June 2, 2006, the FCC released an *Order on Reconsideration of the Second Report and Order*, 21 F.C.C.R. 6703 (hereinafter the Order on Reconsideration).[2] Although it addressed the issues raised in Petitioners' petition for reconsideration, the Order on Reconsideration did not formally grant or deny the petition, but instead was raised by the FCC "on [its] own motion." *Id.* at 6703.

Defending the regulations against the charge that they would unduly restrict DEs to a retail-only business model, the FCC restated and clarified its position that active use of a spectrum license was required to maintain DE status:

> [s]ection 309(j)(4)(D) directs the Commission to issue regulations to 'ensure' that designated entities 'are given the opportunity to participate in the provision of spectrum-based services.' We believe that the word 'participate' in this directive contemplates significant involvement in the provision of services to the public, not merely passive ownership of a license to spectrum used by others to provide service.

Id. at 6705 n.8 (internal citation omitted). In response to Petitioners' arguments that the material-

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[2] Many of the comments just described were submitted after the Order on Reconsideration was released.

relationship rules had not been properly noticed, the FCC noted that the FNPR had asked whether DE relationships with entities other than large in-region incumbents or entities with interests in communications services should be restricted as well. *Id.* at 6711. The FCC also noted that the FNPR had included an open-ended inquiry into what types of relationships should be regulated, and had specifically contemplated the inclusion of lease arrangements among those relationships. *Id.* The FCC concluded that the changes embodied in the final rulemaking were all contained in, or logical outgrowths of, the proposal in the FNPR. *Id.* at 6712.

With respect to the 10-year credit-repayment period, the FCC stated that its decision to apply the new schedule to the preexisting DE qualifications as well as the new ones was also within the scope of its original proposal. The Commission stated that "had we only revised the five-year unjust enrichment schedule for certain types of transactions but not for others, we would have risked creating an illogical scheme that would have created an incentive for designated entities to prioritize certain types of transactions over others." *Id.* at 6716. Turning to the contentions that the 10-year rule would cause DEs' funding to dry up, the FCC was

> not convinced that three to seven years is a reasonable timeframe for investors to expect to recover their capital investments in facilities to provide spectrum-based services. In a recently concluded proceeding addressing the leasing of Educational Broadcast Service

> spectrum, a broad cross-section of commenters, including a private equity investment firm, submitted evidence that insufficient capital would flow to businesses that want to develop that spectrum if the length of spectrum lease terms was limited to fifteen years. These parties argued that lessees needed access to the spectrum for thirty years or more in order to provide the necessary certainty to justify capital investment in the band. The Commission was 'persuaded by [this argument].'

Id. at 6717 (footnotes omitted). Finally, the FCC concluded that even if the new rules did hamper DE capitalization somewhat, this was an acceptable balancing of the statutory goals of encouraging DE participation on the one hand while ensuring that DEs provide "facilities-based service to the public." *Id.* at 6718.

C. The First Petition for Review and the Mandamus Petition

On June 7, 2006 – two days before the Order on Reconsideration was published in the *Federal Register* – Petitioners filed their first petition in this Court for review of the Second R&O, the Order on Reconsideration, and the public notice that had announced the start dates for Auction 66, *Auction of Advanced Wireless Services Licenses Rescheduled for August 9, 2006*, 21 F.C.C.R. 5598 (2006) (hereinafter the Public Notice). Petitioners moved for an emergency stay of Auction 66, which was denied by a motions panel of this Court on June 29,

2006. After briefing and argument on the merits, in September 2007 we held that we lacked jurisdiction to entertain the petition because it was incurably premature. *Council Tree Comm'ns v. FCC*, 503 F.3d 284, 293 (3d Cir. 2007). We noted that by statute, petitions for judicial review of FCC actions can be filed only in the 60 days following "the entry of a final order." *Id.* at 287 (quoting 28 U.S.C. § 2344, citing 47 U.S.C. § 402(a)). We also noted that because the FCC had not formally disposed of Petitioners' motion for reconsideration of the Second R&O, that order was non-final and therefore the petition for its review was premature. *Id.* We further concluded that the Order on Reconsideration was "entered," within the meaning of the statute, only when it was published in the Federal Register, and that we had no jurisdiction to entertain a petition filed *before* this publication. *Id.* at 291-93.

After we issued our opinion, Petitioners sought a writ of mandamus ordering the FCC to act on the petition for reconsideration, to facilitate jurisdiction in this Court. Although we declined to issue a writ of mandamus, on February 15, 2008 we directed the FCC to inform us when it would grant or deny the petition. On March 26, 2008 the FCC formally denied the petition in a brief Second Order on Reconsideration, noting that "we already decided the merits of the Petition in the *Order on Reconsideration*." 23 F.C.C.R. 5425, 5426. Within 60 days of that denial, on April 8, 2008, Petitioners filed this petition for review of the Second R&O,

Order on Reconsideration, Second Order on Reconsideration, and the Public Notice.[3]

D. The Results of Auctions 66 and 73

While Petitioners' first petition for review was pending in 2006, the FCC conducted Auction 66 subject to the rules challenged here. The deadline for applications to bid fell on June 19, 2006; DEs accounted for 166 of 252 applications and 100 out of 168 qualified bidders permitted to participate. Bidding commenced on August 9, 2006, and the auction generated nearly $ 14 billion in winning bids. DEs were 57 of the 104 winning bidders, winning 20% of the individual licenses auctioned. Measured in terms of dollar value, however, DEs won only 4% of the spectrum licenses, although two DEs were among the top ten winners in terms of dollar amounts. By comparison, in auctions held prior to

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[3] It does not appear that the FCC has formally acted on the petitions for reconsideration of the Second R&O that were filed by parties other than Petitioners. This is no barrier to our jurisdiction, however. In *Council Tree* we held only that "[a]n agency order is non-final as to an aggrieved party whose petition for reconsideration remains pending before the agency." 503 F.3d at 287. And indeed, "[i]t is well established . . . that when two parties are adversely affected by an agency's action, one can petition for reconsideration before the agency at the same time that the other seeks judicial redetermination." *W. Penn Power Co. v. EPA*, 860 F.2d 581, 586 (3d Cir. 1988) (citing *Am. Farm Lines v. Black Ball Freight Serv.*, 397 U.S. 532, 541, 90 S. Ct. 1288, 25 L. Ed. 2d 547 (1970)).

the new rules, DEs had won, on average, 70% of the licenses by dollar value.[4]

In late 2007 and early 2008, during and just after the pendency before the FCC of Petitioners' petition for reconsideration, the FCC held another, even larger spectrum auction, known as "Auction 73." Auction 73 generated about $ 19 billion in winning bids, and was also conducted under the rules challenged here. In Auction 73, DEs comprised 119 of 214 qualified bidders and 56 of 101 winners, and won 35% of the individual licenses. They won only 2.6% of the total dollar value of the licenses, however.

II.

Petitioners now petition for review of the Second R&O, the two reconsideration orders, and the Public Notice. Several interested parties, many of them winners at Auctions 66 and 73, have intervened or filed *amicus curiae* briefs in support of the FCC. We have jurisdiction to review the FCC's final orders pursuant to 28 U.S.C. § 2342(1) and 47 U.S.C. § 402(a).[5]

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[4] These data must be considered in light of the absence from Auctions 66 and 73 of the set-asides by which, in prior auctions, only DEs had been permitted to purchase certain spectrum blocks. Also, the purpose of the instant rulemaking from its inception was to disqualify sham DEs, which would be expected to reduce the number of qualifying DEs.

[5] The FCC, along with its intervenors and *amici*, attacks our jurisdiction to review the Public Notice. Because this dispute bears on the remedy for any defects in the rules under review,

Petitioners claim the new regulations are invalid for several reasons. First, they claim that because the new rules were not sufficiently foreshadowed by the FNPR, they were adopted without the public notice and opportunity for comment required by the Administrative Procedure Act.[6] Petitioners also argue that the new rules are arbitrary and capricious, because the FCC made no findings as to their impact on the ability of small businesses to procure financing, and because they ignore the viability of wholesaling as a facilities-based business model for DEs.[7] These challenges differ slightly with

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rather than on the validity of the rules themselves, we consider it after our analysis of the latter issue. *See infra*, Part III.

[6] Petitioners also argue that the rulemaking violated the Regulatory Flexibility Act (RFA), as codified at 5 U.S.C. §§ 603-04. We need not address this theory of recovery further because, on the facts of this case, we regard it as duplicative of the APA notice-and-comment claim: to the extent that the FCC failed to give notice of the new rules for RFA purposes, it also gave inadequate notice for APA purposes, necessitating a remand on the latter basis alone. On remand, of course, the FCC must comply with all RFA requirements.

[7] Petitioners make another subsidiary argument: they claim that the new rules present such obstacles to small businesses' participation in FCC auctions that they violate 47 U.S.C. § 309(j)(3)(B)'s requirement that the Commission "seek to promote" the objective of "economic opportunity and competition . . . by avoiding excessive concentration of licenses and by disseminating licenses among a wide variety of applicants, including small businesses [and] rural telephone companies." But the statute also requires the FCC to promote the development and deployment of new technologies and services, *id.* § 309(j)(3)(A), recover a portion of the value of the spectrum and prevent unjust enrichment, *id.* § 309(j)(3)(C), and ensure "efficient and intensive use" of the spectrum, *id.*

respect to the three provisions challenged here: (1) the 25% attribution rule, (2) the 50% impermissible-relationship rule, and (3) the 10-year credit-repayment schedule.

A. Legal Standard: The Administrative Procedure Act

1. The Notice-and-Comment Requirement

Under the APA, federal agencies must publish "either the terms or substance of the proposed rule or a description of the subjects and issues involved." 5 U.S.C. § 553(b)(3). The APA further requires that "[a]fter notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation." *Id.* § 553(c). In interpreting these provisions, courts have held that if the substance of an agency's final rule strays too far from the description contained in the initial notice, the agency may have deprived interested persons of their statutory right to an opportunity to participate in the rulemaking. *E.g., Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 174, 127 S. Ct. 2339, 168 L. Ed. 2d 54 (2007) ("The Courts of Appeals have generally interpreted this to mean that the final rule the agency adopts must be 'a logical outgrowth' of the

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§ 309(j)(3)(D). Given the general agreement that the DE program can be abused, as well as the continuing participation by DEs in auctions held under the new rules, we cannot conclude that the FCC has failed to promote small-business participation at all.

rule proposed. The object, in short, is one of fair notice.") (quoting *Nat'l Black Media Coal. v. FCC*, 791 F.2d 1016, 1022 (2d Cir. 1986); citing *United Steelworkers, AFL-CIO-CLC v. Marshall*, 647 F.2d 1189, 1221, 208 U.S. App. D.C. 60 (D.C. Cir. 1980) and *S. Terminal Corp. v. EPA*, 504 F.2d 646, 659 (1st Cir. 1974)). The principles governing judicial review of notice-and-comment rulemaking are well established. As the Court of Appeals for the District of Columbia Circuit has put it:

> [n]otice requirements are designed (1) to ensure that agency regulations are tested via exposure to diverse public comment, (2) to ensure fairness to affected parties, and (3) to give affected parties an opportunity to develop evidence in the record to support their objections to the rule and thereby enhance the quality of judicial review. While an agency may promulgate final rules that differ from the proposed rule, a final rule is a logical outgrowth of a proposed rule only if interested parties should have anticipated that the change was possible, and thus reasonably should have filed their comments on the subject during the notice-and-comment period[.] The 'logical outgrowth' doctrine does not extend to a final rule that is a brand new rule, since something is not a logical outgrowth of nothing, nor does it apply where interested parties would have had to divine the Agency's unspoken thoughts, because the final rule was surprisingly distant from the proposed rule[.]

Int'l Union, United Mine Workers v. Mine Safety & Health Admin., 407 F.3d 1250, 1259-60, 366 U.S. App. D.C. 54 (D.C. Cir. 2005) (internal quotation marks, brackets, and citations omitted).

2. The Arbitrary-and-Capricious Standard

Another portion of the APA, codified at 5 U.S.C. § 706(2), provides that on a petition for review of an agency action,

> the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—
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> . . .
>
> (2) hold unlawful and set aside agency action, findings, and conclusions found to be—
>
> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law . . . .

The Supreme Court has stated that

> [t]he scope of review under the 'arbitrary and capricious' standard is narrow and a court is not to substitute its judgment for that of the agency. Nevertheless, the agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made. In

> reviewing that explanation, we must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment. Normally, an agency rule would be arbitrary and capricious if the agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view or the product of agency expertise. The reviewing court should not attempt itself to make up for such deficiencies: [w]e may not supply a reasoned basis for the agency's action that the agency itself has not given. We will, however, uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.

Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43, 103 S. Ct. 2856, 77 L. Ed. 2d 443 (1983) (internal quotation marks and citations omitted). In situations where "an agency has engaged in line-drawing determinations[,]. . . our review is necessarily deferential to agency expertise," but the agency's actions must still "not be 'patently unreasonable' or run counter to the evidence before the agency." *Prometheus Radio Project v. FCC*, 373 F.3d. 372, 390 (3d Cir. 2004) (citations omitted).

B. Validity of the 25% Attribution Rule

1. Notice and Comment Compliance

With the foregoing legal principles in mind, we now consider the rulemaking at issue, beginning with the 25% attributable relationship rule. As noted previously, 47 C.F.R. § 1.2110(b)(1)(i) and (b)(3)(iv)(B) provide that, if a DE leases or resells (including at wholesale) more than 25% of its spectrum capacity to any single lessee or purchaser, it must add that lessee's or purchaser's revenues to its own to determine its continued eligibility for DE credits. Petitioners claim this rule was not adequately noticed in the FNPR, because the FNPR was focused on avoiding domination of DEs by large communications companies, and made no mention of placing limits on all leases to any lessee. We disagree.

As we described previously, the FNPR explicitly sought comment on whether the FCC's definition of restricted "material relationships" should include spectrum leasing arrangements, and also asked whether other relationships should be considered. Moreover, the FNPR solicited comment on how large an entity must be before its relationships with DEs become problematic. In our view, by limiting the permissible combined size of a DE and entities to which it leases one-quarter or more of its spectrum, the final rule squarely addresses these concerns. It is true that, by adopting the attribution approach, the rule focuses not on the size of the related entity, but rather on the *combined* size of the DE itself and the related entity. But we regard this as a logical

outgrowth of the original rule's focus on ensuring that the Commission's "small business provisions . . . be available only to bona fide small businesses." FNPR, 21 F.C.C.R. at 1757, 1767. Therefore, we find no defect of notice in the FCC's enactment of the 25% attribution rule.

2. Arbitrary and Capricious Review

Petitioners also argue that the 25% rule is arbitrary and capricious, because the FCC made no findings on the impact it would have on the ability of DEs to procure financing. According to Petitioners, the FCC could not have articulated a rational connection between the conclusion reached and the facts found, because it found no facts at all.

This question is a close one. Petitioners are correct that the FCC made few factual findings on the impact of the new rules on DE financing. The Commission did observe that "a growing number" of relationships required regulation in order to prevent unjust enrichment. Second R&O, 21 F.C.C.R. at 4762. It also relied on its "experience in administering the designated entity program" in determining that further rules were required. *Id.* at 4762, 4763. The Second R&O acknowledged the concerns of several commenters about the impact any new rules would have on their capitalization arrangements, *see id.* at 4761 & n.65, but the only statement in the Second R&O even approaching a finding in this regard was a recital that the new rules would protect the ability of DEs to raise funds, *id.* at 4764 ("we . . . ensure that [DEs will retain]

flexibility to engage in agreements that are intended to provide [them] with access to valuable capital").

On the other hand, the record reflects the FCC's cognizance of the capitalization issue, and that it engaged in a line-drawing exercise in an attempt to prevent unjust enrichment without unduly impairing DEs' capital access. In the FNPR, the FCC explicitly "recognize[d] that we must strike a delicate balance between encouraging the participation of [genuinely] small businesses . . . and ensuring that those small businesses who do participate . . . have sufficient capital and flexibility," FNPR, 21 F.C.C.R. 1757, and solicited comment on this issue, *id.* at 1767.

Moreover, although the FCC solicited comments from the DE and investment communities with respect to the effects of a rule change on DEs' capitalization, this sort of prediction is inherently speculative. In this regard, we find this case similar to *FCC v. National Citizens Committee for Broadcasting*, 436 U.S. 775, 98 S. Ct. 2096, 56 L. Ed. 2d 697 (1978) (hereinafter *NCCB*). In *NCCB*, the Supreme Court reviewed an FCC rule prohibiting common ownership of newspapers and TV stations where only one of each existed in the relevant geographic market. *Id.* at 796-97. Although the Court found it "inconclusive" whether the rule would actually achieve its stated goal of increasing the diversity of broadcast programming, *id.*, it declared that "[i]n these circumstances, the Commission was entitled to rely on its judgment, based on experience, that it is unrealistic to expect true diversity from a commonly owned station-newspaper combination. The divergency of their viewpoints cannot be

expected to be the same as if they were antagonistically run." *Id.* at 797 (internal quotation marks and citation omitted).

Also at issue in *NCCB* was the FCC's decision not to give the new rules retroactive application with respect to some markets. This was based on the FCC's concern that retroactive application might result in a loss of local ownership of some broadcast stations, require the replacement of incumbent station owners who had performed exceptionally well, or force existing owners to sell their stations at a loss and thus discourage future investment in quality programming. *Id.* at 813. The Court of Appeals found this decision arbitrary, because the record did not indicate the extent to which these problems would actually arise if the divestiture requirement were applied across the board. The Supreme Court reversed, explaining that

> to the extent that factual determinations were involved in the Commission's decision to "grandfather" most existing combinations, they were primarily of a judgmental or predictive nature – *e.g.*, whether a divestiture requirement would result in trading of stations with out-of-town owners; whether new owners would perform as well as existing crossowners, either in the short run or in the long run; whether losses to existing owners would result from forced sales; whether such losses would discourage future investment in quality programming; and whether new owners would have sufficient working capital to finance local programming. In such

> circumstances complete factual support in the record for the Commission's judgment or prediction is not possible or required; a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency.

Id. (internal quotation marks and citation omitted).

Like in *NCCB*, here the FCC's attempts at factfinding relevant to the impact of its proposed rules on DE financing were thin, perhaps because of its haste in promulgating rules before Auction 66. As a result, the Commission's consideration of the matter is neither as clear nor as thorough as would be ideal. Nonetheless, in light of the great deference to agency experience that we owe "where the issues involve 'elusive' and 'not easily defined' areas" such as this, *Prometheus Radio Project*, 373 F.3d. at 390 (quoting *Sinclair Broad. Group v. FCC*, 284 F.3d 148, 159, 350 U.S. App. D.C. 313 (D.C. Cir. 2002)), we conclude that the FCC offered enough consideration of DE capitalization to pass the arbitrary and capricious threshold with respect to the 25% attribution rule.

For these reasons, we will deny the petition insofar as it challenges the 25% attribution rule, and uphold the validity of 47 C.F.R. § 1.2110(b)(1)(i) and (b)(3)(iv)(B).

C. The 50% Impermissible-Relationship Rule

1. Notice and Comment Compliance

We next consider 47 C.F.R. § 1.2110(b)(3)(iv)(A), which makes license applicants or holders ineligible for DE benefits if they lease or resell (including at wholesale) more than 50% of their spectrum capacity. Aside from the difference in percentages, this rule diverges from the 25% attribution rule in two crucial ways. First, the 50% impermissible-relationship rule considers the *aggregate* portion of spectrum capacity that a licensee has leased or resold, rather than the portion of capacity leased to an individual lessee as does the 25% rule. Second, the 50% rule is a *per se* disqualification from DE status, rather than a mere attribution requirement. These two characteristics are the essential elements of the rule.

The aggregation element of the 50% rule was not mentioned in the FNPR, nor, in our view, can it be regarded as a logical outgrowth of the concerns addressed therein. The FNPR was focused on ensuring that a DE remains a genuinely small business, rather than a front entity controlled or heavily influenced by a large entity that is not eligible for bidding credits. As we noted, the 25% attribution rule addresses this concern directly by limiting the allowable combined size of groups of related license holders or users which include DEs. By contrast, because the 50% rule involves aggregation of all of a DE's lease or resale agreements, it would deny DE status to a small company that leases or resells 5.1% of its spectrum

capacity to each of ten other companies, regardless of how small those lessees or buyers, or all of them combined, might be. It is true, of course, that this aggregation rule also strips DE status from small businesses that lease or resell almost all of their spectrum to several large carriers, in chunks of just under 25%. But we find no basis in the record to conclude that either type of arrangement would threaten to give any single large buyer or lessee – or DE-buyer-lessee grouping – undue influence over a DE in the manner the FNPR sought to address. Instead, DEs that run afoul of the 50% rule may often employ a business model relying on a large number of relatively small-scale transactions with a group of third parties who compete against each other in the wireless services market. We regard this as exactly of the kind of DE independence that the FNPR was concerned with preserving, and the record contains no indication to the contrary.

Indeed, as we described above, the Second Report and Order makes clear that the FCC's real concern in promulgating the 50% impermissible-relationship rule was not to prevent DEs from being unduly influenced by large entities or groups of entities, but rather was to ensure that DEs are primarily engaged in offering wireless services to the public. But the FNPR had not so much as hinted that this was the objective of the rulemaking: it mentioned "service to the public" only twice, both times in the course of describing the FCC's obligation to ensure that DEs have access to capital to help them provide such service. *See* FNPR, 21 F.C.C.R. 1753 at 1757, 1767. Instead, as we have explained, the FNPR was

focused on maintaining the independence of DEs from larger entities.

We also find it instructive that the FCC had previously solicited broader comment on the permissibility of leasing arrangements involving DEs, and in much more specific terms than it did here. In 2003 the FCC issued a Report and Order and Further Notice of Proposed Rulemaking in *In re Promoting Efficient Use of Spectrum Through Elimination of Barriers to the Development of Secondary Markets*, 18 F.C.C.R. 20,604 (October 6, 2003), in which it significantly relaxed previous restrictions – which had applied to DEs and non-DEs alike – on the leasing or reselling of spectrum licenses. In promulgating this change, the FCC stated it had "sought to ensure that its approach would not invite circumvention of the underlying purposes of these designated entity-related policies and rules," *id.* at 20,627, and summarized the extensive comments it had received directly addressing both sides of the issue, *id.* at 20,629, before concluding that

> [a] designated entity and/or entrepreneur licensee may lease to any spectrum lessee and avoid the application of our unjust enrichment rules and/or transfer restrictions so long as the lease does not result in the lessee becoming a 'controlling interest' or affiliate that would cause the licensee to lose its designated entity or entrepreneur status.

Id. at 20,654-55. The Commission also sought comment on possible further rulemaking, asking:

> [s]hould we require a lessee to be eligible for the same level of competitive bidding benefits, such as bidding credits, as the licensee from which it is leasing? Should we require only that the lessee be qualified to hold the license? If so, do we impose unjust enrichment obligations on a lessee that is qualified for a lesser level of competitive bidding benefits?

Id. at 20,698. In the final rule that emerged from this additional process, the FCC reiterated that DEs were free to lease their spectrum so long as they met the requirements applicable to all licensees. Second Report and Order *In re Promoting Efficient Use of Spectrum through Elimination of Barriers to the Development of Secondary Markets*, 19 F.C.C.R. 17,503, 17,543-44 (2004) ("[W]e will . . . amend the language of our rules to clarify that, subject to the other eligibility restrictions . . . a designated entity or entrepreneur licensee may enter into a spectrum manager leasing arrangement with any spectrum lessee, regardless of the lessee's eligibility for designated entity or entrepreneur benefits.").

The contrast could not be more stark between the transparent discussion of DE leasing rights from 2003-04 on the one hand, and the run up to the rules promulgated in 2006 by the Second R&O on the other. The FNPR here gave no indication that the FCC intended to revisit an issue it had thoroughly addressed only three years before. Commenters could not reasonably have anticipated that, in inquiring in the FNPR whether leasing arrangements between DEs and large wireless carriers impaired the DEs' bona fide small business

status, the FCC was proposing to revise the general limits on DEs' ability to lease their spectrum to anyone at all. Even if this *was* the FCC's intent, "an unexpressed intention cannot convert a final rule into a 'logical outgrowth' that the public should have anticipated." *Shell Oil Co. v. EPA*, 950 F.2d 741, 751, 292 U.S. App. D.C. 332 (D.C. Cir. 1991). Accordingly, we hold that the 50% impermissible-relationship rule, as codified at 47 C.F.R. § 1.2110(b)(3)(iv)(A), was promulgated without the notice and comment required by the APA.[8]

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[8] Because we find the notice invalid under the APA, we do not reach the question of whether the rule was arbitrary or capricious. Nevertheless, we note the Commission's inattention to the nature of the wireless wholesaling business. Both the 25% and 50% rules apply to wholesaling of wireless services by DEs. The record discloses that to engage in wireless wholesaling, a licensee must do considerably more than obtain and then lease or resell the spectrum license itself. Instead, the wholesaler must build and operate the physical facilities required to transmit and receive wireless signals, and to transfer those signals to or from other networks or end users. It is *this* service that is sold at wholesale. This raises a separate set of questions and concerns from those raised when a DE merely monetizes its credits or partners with a large carrier, thus rendering the DE's separate existence a mere formality.

Given the extensive provision of services entailed in wireless wholesaling, it is not at all obvious that the FCC's rationale for the 50% impermissible-relationship rule – ensuring that DEs offer service to the public, rather than simply handing their spectrum over to larger carriers – should necessarily require prohibiting DEs from engaging primarily in the wholesale business, so long as they do not sell or lease overly large quantities of their capacity to any single lessee or buyer. The FCC appears to have failed to even acknowledge this issue. We commend it to the Commission's attention on remand.

D. The Ten Year Repayment Schedule

1. Notice and Comment Compliance

We last turn to Petitioners' challenges to the changes to 47 C.F.R. § 1.2111(d)(2)(i) that extended from five to ten years the period during which a licensee must repay its bidding credits, in whole or in part, if it loses its DE status. The FNPR plainly offered notice that the FCC was trying to determine the proper length of the repayment period attached to any *new* DE qualifications that it might adopt. Petitioners argue, however, that the FNPR did not indicate that the FCC was considering changing the repayment terms attached to then-existing DE qualifications. As we noted previously, much of the protest that greeted the new rules was directed toward this extension of the repayment term, and the alleged lack of notice of this change.

The FCC responds by noting that it has never attached differing bidding-credit repayment schedules to different qualifications for DE status, because this would permit DEs looking to enter into suspect relationships to structure their arrangements to minimize the penalty involved. Thus, the Commission maintains that by soliciting comment on the repayment period attached to new regulations in the FNPR, it implicitly proposed changing the corresponding period for existing rules. We disagree.

Noting our decision in *Wagner Electric Corp. v. Volpe*, 466 F.2d 1013 (3d Cir. 1972), Petitioners argue persuasively that this sort of implied notice is

insufficient unless all interested persons would reasonably be expected to perceive the implication. In *Wagner*, the National Highway Traffic Safety Administration (NHTSA) had published a notice of proposed rulemaking in which it proposed to eliminate the permissible failure rate for automobile turn signals and warning flashers. The effect of this change would have been to require that 100% of those products meet the NHTSA's standards for regularity of flashing, durability, and other features. After comments, however, the NHTSA concluded that 100% compliance with its current regulations was technologically infeasible. In the final rule, it nevertheless enacted the 100% compliance requirement, but dealt with the infeasibility problem by significantly relaxing the substance of the standards. On review, faced with the argument that its notice of proposed rulemaking had not presaged this change, the NHTSA argued that relaxing the substantive standards was a logical means of increasing the compliance rate, and noted that some of the commenters had actually suggested as much. *Id.* at 1018-19. We rejected this argument, holding that even if some sophisticated observers would have seen the connection between the stricter compliance that had been noticed and the lower standards eventually announced, the proper question under the APA was whether the agency had provided notice to all "interested parties." *Id.* at 1019. We held that the inferential notice purportedly provided by the NHTSA did not satisfy that standard. *Id.* at 1020-21.

Here, the FNPR solicited comment on the length of the bidding-credit repayment schedule attached to

any new DE qualifications. From this – and from the fact that the repayment schedule had previously always been uniform across all DE qualifications – the FCC argues that interested parties should have inferred that the repayment schedule for all qualifications was under review. As in *Wagner*, this purported inferential notice was insufficient to satisfy the APA.

Even if the kind of inferential notice the FCC advances were sufficient under the APA, we do not find the FNPR to provide such notice. Nothing in the record forecloses the commonsense conclusion that because some violations of DE status are more serious than others, it would make sense to attach more stringent penalties to them, including more severe bidding-credit repayment requirements. Thus, far from communicating the need for an across-the-board repayment period, to many interested parties, the FNPR's solicitation of comments only on the repayment schedule for the *proposed* qualifications could well have appeared to be an attempt to calibrate the penalties for violations of the new rules with those for violations of existing rules. Indeed, no commenter manifested an understanding that the FCC was considering changing the existing repayment schedule. The only commenter to suggest adopting a 10-year repayment period – MMTC, a petitioner here – specifically suggested that the FCC "*consider initiating an inquiry*" into doing so, apparently in an entirely separate rulemaking. Comments of the Minority Media and Telecomm'ns Council, J.A. at 586

(emphasis added).[9] Accordingly, we hold that the 10-year repayment schedule, to the extent it applies to qualifications for DE status that were in effect before its enactment, was adopted without the notice and comment required by the APA.[10]

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[9] The FCC also points to Council Tree's own request that the preexisting repayment schedule be applied to any new DE qualifications that might be adopted. *See* Comments of Council Tree Comm'ns, Inc., J.A. 497-99. But this does not even begin to manifest an understanding by Council Tree that the preexisting schedule might be *changed*.

[10] As we stated above, there was more than adequate notice that the new repayment schedule would apply to any *new* rules adopted by the FCC. Because we leave intact the 25% rule, there is therefore no notice-or-comment barrier to the 10-year schedule's application to that rule. Nonetheless, we find it necessary to vacate the 10-year schedule in whole, because we see no way to sever the FCC's legitimate adoption of the 10-year schedule with respect to the 25% rule from its unlawful application of the rule to other situations. The Second R&O set forth a single repayment schedule to govern all DE qualifications, both those created in the Second R&O and those that preexisted it. *See* 21 F.C.C.R. at 4794; 47 C.F.R. § 1.2111(d)(1). Thus, we can strike down the regulation as it applies to the preexisting qualifications only by invalidating it across the board.

Although we do not reach Petitioners' contention that the extended repayment schedule is arbitrary and capricious, we also note that the FCC does not appear to have thoroughly considered the impact of the extended repayment schedule on DEs' ability to retain financing. In the Reconsideration Order, the FCC concluded that a shorter time to liquidity of a DE's spectrum licenses was not necessary, because

> [i]n a recently concluded proceeding addressing the leasing of Education Broadcast Service spectrum, a broad cross-section of commenters, including a private equity investment firm, submitted evidence that

III.

The proper remedy remains to be considered. The FCC suggests that, to the extent we find the rules defective, we remand the matter without vacatur to permit it to correct the defects. Petitioners, by contrast, urge not only that we vacate the rules before remand, but also that we exercise our equitable authority to rescind Auctions 66 and 73.[11]

Petitioners' proposal is vigorously opposed by the FCC and by several intervenors and *amici*, including

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> insufficient capital would flow to businesses that want to develop that spectrum if the length of spectrum lease terms was limited to fifteen years. These parties argued that lessees needed access to the spectrum for thirty years or more in order to provide the necessary certainty to justify capital investment in the band. The Commission was 'persuaded by [this argument]. [Therefore,] we are not convinced that the appropriate investment horizon for designated entity status should be only three to seven years.

21 F.C.C.R. at 6717-18. From this comment, it seems that the FCC has confused the maximum period for which investors are willing to lock up their capital (before being able to liquidate the spectrum license, in the event the DE proves unprofitable) with the *minimum* period necessary for financiers to turn a profit on a successful investment in educational broadcast services. We commend this issue as well to the FCC's attention on remand.

[11] Petitioners acknowledge that several other much smaller auctions have been conducted under the new rules, and that the logic of their position would also support rescission of those results as well. Nevertheless, they request nullification only of Auctions 66 and 73.

some winners of Auctions 66 and 73.[12] The record gives no indication that these intervenors and *amici*, or other winners of Auctions 66 and 73, were anything but innocent third parties in relation to the FCC's improper rulemaking. We are thus loath to rescind the results of the auctions, since it would involve unwinding transactions worth more than $ 30 billion, upsetting what are likely billions of dollars of additional investments made in reliance on the results, and seriously disrupting existing or planned wireless service for untold numbers of customers. Moreover, the possibility of such large-scale disruption in wireless communications would have broad negative implications for the public interest in general.

In an attempt to address these concerns, Petitioners suggest that we nullify the auction results, but permit the winning bidders to keep their licenses unless and until they are won by another bidder at re-auction. This might mitigate the chaos of a rescission, but it could not eliminate the massive uncertainty, waste, and frozen development that would occur from the time of the rescission until the re-auction which, as the FCC might wish to adopt additional rules before the re-auction to replace the ones at issue here, could be a significant period of time. Additionally, some of the intervenors, who were winners in Auction 66 in 2006, note that the

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[12] The FCC, intervenors and *amici* also contest our jurisdiction to overturn the auction results. As we will explain, we would decline to exercise any jurisdiction we may have to rescind the auction results. Accordingly, we will not address this matter further.

state of the economy and the credit markets has changed dramatically since the auction; consequently, their participation in any re-auction might be impractical or impossible. A re-auction thus would unfairly require these intervenors to pay sums that they may not have in order to protect investments they have already made, and perhaps cannot recoup without the relevant spectrum licenses. Under these circumstances, we conclude that it would be imprudent and unfair to order rescission of the auction results.

But we are also unreceptive to the FCC's suggestion that we remand the matter without vacating the challenged rules. The FCC argues we are authorized to do so based on a balancing of "the seriousness of the . . . deficiencies (and thus the extent of doubt whether the agency chose correctly) and the disruptive consequences of an interim change that may itself be changed," *Chamber of Commerce of U.S. v. SEC*, 443 F.3d 890, 908, 370 U.S. App. D.C. 249 (D.C. Cir. 2006) (quoting *Allied-Signal, Inc. v. Nuclear Regulatory Comm'n*, 988 F.2d 146, 150-51, 300 U.S. App. D.C. 198 (D.C.Cir.1993)).[13] We find the deficiencies in the

[13] Petitioners argue that we are required to vacate any rules we find in violation of the APA, pointing out that the APA requires us to "hold unlawful *and set aside*" any such agency action. 5 U.S.C. § 706(2) (emphasis added). The FCC, however, cites to a case in which we remanded without vacatur, albeit without commenting on the issue. See *Am. Iron & Steel Inst. v. EPA*, 568 F.2d 284, 310 (3d Cir. 1977). Because we find remand without vacatur to be inappropriate on the facts of this case, we express no view as to whether we are authorized to order this remedy.

challenged rulemaking to be serious. On the other hand, vacating the 50% impermissible relationship rule will mean that DEs will be free to lease or wholesale as much of their spectrum as they wish, subject to revenue attribution should they lease or wholesale more than 25% of their spectrum to a single entity. Vacating the 10-year-hold rule will simply mean that DEs' repayment obligations will once again be governed by the previous 5-year schedule.[14] *See Abington Mem. Hosp. v. Heckler*, 750 F.2d 242, 244 (3d Cir. 1984) (citing *Action on Smoking and Health v. CAB*, 713 F.2d 795, 797, 230 U.S. App. D.C. 1 (D.C. Cir. 1983), for the proposition that "vacating or rescinding invalidly promulgated regulations has the effect of reinstating prior regulations"); *Paulsen v. Daniels*, 413 F.3d 999, 1008 (9th Cir. 2005) ("The effect of invalidating an agency rule is to reinstate the rule previously in force."). We do not regard either of these situations as likely to create any serious disruption. Accordingly, even assuming we have the authority to remand the matter without vacatur, we would decline to do so here. Instead, we will vacate the 50% and 10-year rules and remand the matter to the FCC.

IV.

In sum, the FCC's 25% attribution rule was promulgated after the public notice and opportunity

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[14] Because we will leave in place 47 C.F.R. § 1.2111(d)(1), which makes the repayment schedule of § 1.2111(d)(2)(i) applicable to violations of the new 25% attribution rule which we also leave in place, violations of the 25% rule will also be governed by the preexisting five-year schedule.

to comment required by the APA, and is not arbitrary and capricious. The 50% impermissible-relationship rule, however, was promulgated without the requisite notice and opportunity to comment. The 10-year bidding-credit repayment schedule likewise was promulgated in substantial and inseverable part without notice or comment. Accordingly, we will deny the petition with respect to the attributable-material-relationship rule articulated in 47 C.F.R. § 1.2110(b)(1) and (b)(3)(iv)(B). We will grant the petition with respect to the impermissible material relationship rule contained in 47 C.F.R. § 1.2110(b)(3)(iv)(A) and the 10-year-hold rule contained in 47 C.F.R.§ 1.2111(d)(2)(i). We will vacate the impermissible material relationship rule and the 10-year-hold rule, order the reinstatement of the previous version of 47 C.F.R. § 1.2111(d)(2), and remand the matter to the FCC for further proceedings.

STATUTORY APPENDIX

I. Administrative Procedure Act Pub L. No. 79-404 (60 Stat. 238)

As amended and codified in Title 5 of the United States Code § 500 et seq., Recodified by Pub L. No. 89-554, Sept. 6, 1966 (80 Stat. 383), the Administrative Procedure Act provides, in relevant part:

§ 551. Definitions

For the purpose of this subchapter—

(1) "agency" means each authority of the Government of the United States, whether or not it is within or subject to review by another agency, but does not include—

(A) the Congress;

(B) the courts of the United States;

(C) the governments of the territories or possessions of the United States;

(D) the government of the District of Columbia; or except as to the requirements of section 552 of this title [5 USCS § 552]—

(E) agencies composed of representatives of the parties or of representatives of organizations of the parties to the disputes determined by them;

(F) courts martial and military commissions;

(G) military authority exercised in the field in time of war or in occupied territory; or

(H) functions conferred by sections 1738, 1739, 1743, and 1744 of title 12; chapter 2 of title 41 [41 USCS §§ 101 et seq.]; subchapter II of chapter 471 of title 49 [49 USCS §§ 47151 et seq.]; or sections 1884, 1891-1902, and former section 1641(b)(2), of title 50, appendix;

(2) "person" includes an individual, partnership, corporation, association, or public or private organization other than an agency;

(3) "party" includes a person or agency named or admitted as a party, or properly seeking and entitled as of right to be admitted as a party, in an agency proceeding, and a person or agency admitted by an agency as a party for limited purposes;

(4) "rule" means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing;

(5) "rule making" means agency process for formulating, amending, or repealing a rule;

(6) "order" means the whole or a part of a final disposition, whether affirmative, negative, injunctive, or declaratory in form, of an agency in a matter other than rule making but including licensing;

(7) "adjudication" means agency process for the formulation of an order;

(8) "license" includes the whole or a part of an agency permit, certificate, approval, registration, charter, membership, statutory exemption or other form of permission;

(9) "licensing" includes agency process respecting the grant, renewal, denial, revocation, suspension, annulment, withdrawal, limitation, amendment, modification, or conditioning of a license;

(10)"sanction" includes the whole or a part of an agency—

(A) prohibition, requirement, limitation, or other condition affecting the freedom of a person;

(B) withholding of relief;

(C) imposition of penalty or fine;

(D) destruction, taking, seizure, or withholding of property;

(E) assessment of damages, reimbursement, restitution, compensation, costs, charges, or fees;

(F) requirement, revocation, or suspension of a license; or

(G) taking other compulsory or restrictive action;

(11)"relief" includes the whole or a part of an agency—

(A) grant of money, assistance, license, authority, exemption, exception, privilege, or remedy;

(B) recognition of a claim, right, immunity, privilege, exemption, or exception; or

(C) taking of other action on the application or petition of, and beneficial to, a person;

(12)"agency proceeding" means an agency process as defined by paragraphs (5), (7), and (9) of this section;

(13)"agency action" includes the whole or a part of an agency rule, order, license, sanction, relief, or the equivalent or denial thereof, or failure to act; and

* * * *

§ 553. Rule making

(a) This section applies, according to the provisions thereof, except to the extent that there is involved—

(1) a military or foreign affairs function of the United States; or

(2) a matter relating to agency management or personnel or to public property, loans, grants, benefits, or contracts.

(b) General notice of proposed rule making shall be published in the Federal Register, unless persons

subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—

(1) a statement of the time, place, and nature of public rule making proceedings;

(2) reference to the legal authority under which the rule is proposed; and

(3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

Except when notice of hearing is required by statute, this subsection does not apply—

(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or

(B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

(c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing,

sections 556 and 557 of this title apply instead of this subsection.

(d) The required publication or service of a substantive rule shall be made not less than 30 days before its effective date, except—

(1) a substantive rule which grants or recognizes an exemption or relieves a restriction;

(2) interpretative rules and statements of policy; or

(3) as otherwise provided by the agency for good cause found and published with the rule.

(e) Each agency shall give an interested person the right to petition for the issuance, amendment, or repeal of a rule.

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§ 705. Relief pending review

When an agency finds that justice so requires, it may postpone the effective date of action taken by it, pending judicial review. On such conditions as may be required and to the extent necessary to prevent irreparable injury, the reviewing court, including the court to which a case may be taken on appeal from or on application for certiorari or other writ to a reviewing court, may issue all necessary and appropriate process to postpone the effective date of an agency action or to preserve status or rights pending conclusion of the review proceedings.

§ 706. Scope of review

To the extent necessary to decision and when

presented, the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of an agency action. The reviewing court shall—

(1) compel agency action unlawfully withheld or unreasonably delayed; and

(2) hold unlawful and set aside agency action, findings, and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(B) contrary to constitutional right, power, privilege, or immunity;

(C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;

(D) without observance of procedure required by law;

(E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or

(F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.

In making the foregoing determinations, the court shall review the whole record or those parts of it cited by a party, and due account shall be taken of the rule of prejudicial error.

II. Communications Act of 1934 Pub L. No. 416 (48 Stat. 1064)

As amended and codified in Chapter 5 of Title 47 of the United States Code, 47 U.S.C. § 151 et seq., the Communications Act of 1934, in relevant part:

§ 151 Purposes of Act, Creation of Federal Communications Commission

For the purpose of the regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States, without discrimination, on the basis of race, color, religion, national origin, or sex, a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is hereby created a commission to be known as the "Federal Communications Commission," which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this Act.

§ 309(j)(1)&(2)

(j) USE OF COMPETITIVE BIDDING.—

(1) General authority.—If, consistent with the obligations described in paragraph (6)(E), mutually exclusive applications are accepted for any initial license or construction permit, then, except as provided in paragraph (2), the Commission shall grant the license or permit to a qualified applicant through a system of competitive bidding that meets the requirements of this subsection.

(2) EXEMPTIONS.—The competitive bidding authority granted by this subsection shall not apply to licenses or construction permits issued by the Commission—

(A) for public safety radio services, including private internal radio services used by State and local governments and non-government entities and including emergency road services provided by not-for-profit organizations, that—

(i) are used to protect the safety of life, health, or property; and

(ii) are not made commercially available to the public;

(B) for initial licenses or construction permits for digital television service given to existing terrestrial broadcast licensees to replace their analog television service licenses; or

(C) for stations described in Section 397(6) of this Act.

§ 309(j)(3)

(3) DESIGN OF SYSTEMS OF COMPETITIVE BIDDING.—For each class of licenses or permits that the Commission grants through the use of a competitive bidding system, the Commission shall, by regulation, establish a competitive bidding methodology. The Commission shall seek to design and test multiple alternative methodologies under appropriate circumstances. The Commission shall, directly or by contract, provide for the design and conduct (for purposes of testing) of competitive bidding using a contingent combinatorial bidding system that permits prospective bidders to bid on combinations or groups of licenses in a single bid and to enter multiple alternative bids within a single bidding round. In identifying classes of licenses and permits to be issued by competitive bidding, in specifying eligibility and other characteristics of such licenses and permits, and in designing the methodologies for use under this subsection, the Commission shall include safeguards to protect the public interest in the use of the spectrum and shall seek to promote the purposes specified in Section 1 of this Act and the following objectives:

(A) the development and rapid deployment of new technologies, products, and services for the benefit of the public, including those residing in rural areas, without administrative or judicial delays;

(B) promoting economic opportunity and competition and ensuring that new and innovative technologies are readily accessible to the American people by avoiding excessive concentration of licenses

and by disseminating licenses among a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women;

(C) recovery for the public of a portion of the value of the public spectrum resource made available for commercial use and avoidance of unjust enrichment through the methods employed to award uses of that resource;

(D) efficient and intensive use of the electromagnetic spectrum; and

(E) ensure that, in the scheduling of any competitive bidding under this subsection, an adequate period is allowed—

(i) before issuance of bidding rules, to permit notice and comment on proposed auction procedures; and

(ii) after issuance of bidding rules, to ensure that interested parties have a sufficient time to develop business plans, assess market conditions, and evaluate the availability of equipment for the relevant services.

§ 309(j)(4)

(4) CONTENTS OF REGULATIONS. In prescribing regulations pursuant to paragraph (3), the Commission shall—

(A) consider alternative payment schedules and methods of calculation, including lump sums or guaranteed installment payments, with or without royalty payments, or other schedules or

methods that promote the objectives described in paragraph(3)(B), and combinations of such schedules and methods;

(B) include performance requirements, such as appropriate deadlines and penalties for performance failures, to ensure prompt delivery of service to rural areas, to prevent stockpiling or warehousing of spectrum by licensees or permittees, and to promote investment in and rapid deployment of new technologies and services;

(C) consistent with the public interest, convenience, and necessity, the purposes of this Act, and the characteristics of the proposed service, prescribe area designations and bandwidth assignments that promote (i) an equitable distribution of licenses and services among geographic areas, (ii) economic opportunity for a wide variety of applicants, including small businesses, rural telephone companies, and businesses owned by members of minority groups and women, and (iii) investment in and rapid deployment of new technologies and services;

(D) ensure that small businesses, rural telephone companies, and businesses owned by members of minority groups and women are given the opportunity to participate in the provision of spectrum-based services, and, for such purposes, consider the use of tax certificates, bidding preferences, and other procedures;

(E) require such transfer disclosures and antitrafficking restrictions and payment schedules as may be necessary to prevent unjust enrichment as a

result of the methods employed to issue licenses and permits; and

(F) prescribe methods by which a reasonable reserve price will be required, or a minimum bid will be established, to obtain any license or permit being assigned pursuant to the competitive bidding, unless the Commission determines that such a reserve price or minimum bid is not in the public interest.

§ 309(j)(5)

(5) BIDDER AND LICENSEE QUALIFICATION.—No person shall be permitted to participate in a system of competitive bidding pursuant to this subsection unless such bidder submits such information and assurances as the Commission may require to demonstrate that such bidder's application is acceptable for filing. No license shall be granted to an applicant selected pursuant to this subsection unless the Commission determines that the applicant is qualified pursuant to subsection (a) and Sections 308(b) and 310. Consistent with the objectives described in paragraph (3), the Commission shall, by regulation, prescribe expedited procedures consistent with the procedures authorized by subsection (i)(2) for the resolution of any substantial and material issues of fact concerning qualifications.

§ 309(j)(6)

(6) RULES OF CONSTRUCTION.—Nothing in this subsection, or in the use of competitive bidding, shall—

(A) alter spectrum allocation criteria and procedures established by the other provisions of this Act;

(B) limit or otherwise affect the requirements of subsection (h) of this section, Sections 301, 304, 307, 310, or 706, or any other provision of this Act (other than subsections (d)(2) and (e) of this section);

(C) diminish the authority of the Commission under the other provisions of this Act to regulate or reclaim spectrum licenses;

(D) be construed to convey any rights, including any expectation of renewal of a license, that differ from the rights that apply to other licenses within the same service that were not issued pursuant to this subsection;

(E) be construed to relieve the Commission of the obligation in the public interest to continue to use engineering solutions, negotiation, threshold qualifications, service regulations, and other means in order to avoid mutual exclusivity in application and licensing proceedings;

(F) be construed to prohibit the Commission from issuing nationwide, regional, or local licenses or permits;

(G) be construed to prevent the Commission from awarding licenses to those persons who make significant contributions to the development of a new telecommunications service or technology; or

(H) be construed to relieve any applicant for a license or permit of the obligation to pay charges imposed pursuant to Section 8 of this Act.

§ 309(j)(7)

(7) CONSIDERATION OF REVENUES IN PUBLIC INTEREST DETERMINATIONS.—

(A) CONSIDERATION PROHIBITED.—In making a decision pursuant to Section 303(c) to assign a bank of frequencies to use for which licenses or permits will be issued pursuant to this subsection, and in prescribing regulations pursuant (4)(C) of this subsection, the Commission may not base a finding of public interest, convenience, and necessity on the expectation of Federal revenues from the use of a system of competitive bidding under this subsection.

(B) CONSIDERATION LIMITED.—In prescribing regulations pursuant to paragraph(4)(A) of this Subsection, the Commission may not base a finding of public interest, convenience, and necessity solely or predominantly on the expectation of Federal revenues from the use of a system of competitive bidding under this subsection.

(C) CONSIDERATION OF DEMAND FOR SPECTRUM NOT AFFECTED.—Nothing in this paragraph shall be construed to prevent the Commission from continuing to consider consumer demand for spectrum-based services.

§ 402. PROCEEDINGS TO ENJOIN, SET ASIDE, ANNUL OR SUSPEND ORDERS OF THE COMMISSION

(a) Any proceeding to enjoin, set aside, annul or suspend any order of the Commission under this Act (except those appealable under subsection (b) of this section) shall be brought as provided by and in the manner prescribed in Chapter 158 of Title 28, United States Code.

OTHER AUTHORITIES

I. FCC Rules & Regulations, 47 C.F.R. Ch. 1 (10-1-05 Edition)

The following sections are the pertinent FCC rules *prior* to the adoption of the *Second Report and Order and Second Further Notice of Proposed Rulemaking*, WT Docket No. 05-211, 21 F.C.C.R. 4753 (2006).

§ 1.2110 Designated entities.

(a) Designated entities are small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies.

(b) *Eligibility for small business and entrepreneur provisions*—(1) *Size attribution.* (i) The gross revenues of the applicant (or licensee), its affiliates, its controlling interests, and the affiliates of the applicant's controlling interests shall be attributed to the applicant and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules. An applicant seeking status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules, must disclose on its short and long-form applications, separately and in the aggregate, the gross revenues of the applicant (or licensee), its affiliates, its controlling interests, and the affiliates of the applicant's controlling interests for each of the previous three years.

(ii) If applicable, pursuant to § 24.709 of this chapter, the total assets of the applicant (or licensee), its affiliates, its controlling interests and affiliates of the applicant's controlling interests shall be attributed to the applicant and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as an entrepreneur. An applicant seeking status as an entrepreneur must disclose on its short and long-form applications, separately and in the aggregate, the gross revenues of the applicant (or licensee), its affiliates, its controlling interests and affiliates of the applicant's controlling interests for each of the previous two years.

* * * *

(c) *Definitions*—(1) *Small businesses.* The Commission will establish the definition of a small business on a service specific basis, taking into consideration the characteristics and capital requirements of the particular service.

* * * *

(4) *Rural telephone companies.* A rural telephone company is any local exchange carrier operating entity to the extent that such entity—

(i) Provides common carrier service to any local exchange carrier study area that does not include either:

(A) Any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census, or

(B) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(ii) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(iii) Provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(iv) Has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996.

* * * *

(f) *Bidding credits.* (1) The Commission may award bidding credits (*i.e.*, payment discounts) to eligible designated entities. Competitive bidding rules applicable to individual services will specify the designated entities eligible for bidding credits, the licenses for which bidding credits are available, the amounts of bidding credits and other procedures.

(2) *Size of bidding credits.* A winning bidder that qualifies as a small business or a consortium of small businesses may use the following bidding credits corresponding to their respective average gross revenues for the preceding 3 years:

(i) Businesses with average gross revenues for the preceding years, 3 years not exceeding $3 million are eligible for bidding credits of 35 percent;

(ii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $15

million are eligible for bidding credits of 25 percent; and

(iii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $40 million are eligible for bidding credits of 15 percent.

* * * *

§ 1.2111 Assignment or transfer of control: unjust enrichment.

* * * *

(d) *Unjust enrichment payment: bidding credits.* (1) A licensee that utilizes a bidding credit, and that during the initial term seeks to assign or transfer control of a license to an entity that does not meet the eligibility criteria for a bidding credit, will be required to reimburse the U.S. Government for the amount of the bidding credit, plus interest based on the rate for ten year U.S. Treasury obligations applicable on the date the license was granted, as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to assign or transfer control of a license to an entity that is eligible for a lower bidding credit, the difference between the bidding credit obtained by the assigning party and the bidding credit for which the acquiring party would qualify, plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee

that utilizes a bidding credit seeks to make any ownership change that would result in the licensee losing eligibility for a bidding credit (or qualifying for a lower bidding credit), the amount of the bidding credit (or the difference between the bidding credit originally obtained and the bidding credit for which the restructured licensee would qualify), plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer.

(2) *Payment schedule.* (i) The amount of payments made pursuant to paragraph (d)(1) of this section will be reduced over time as follows:

(A) A transfer in the first two years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of very small businesses transferring to small businesses, 100 percent of the difference between the bidding credit received by the former and the bidding credit for which the latter is eligible);

(B) A transfer in year 3 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit;

(C) A transfer in year 4 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit;

(D) A transfer in year 5 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit; and

(E) for a transfer in year 6 or thereafter, there will be no payment.

(ii) These payments will have to be paid to the United States Treasury as a condition of approval of the assignment, transfer, or ownership change.

* * * *

II. FCC Rules & Regulations, 47 C.F.R. Ch. 1 (10-1-06 Edition)

The following sections are the pertinent FCC rules *after* adoption of the *Second Report and Order and Second Further Notice of Proposed Rulemaking*, WT Docket No. 05-211, 21 F.C.C.R. 4753 (2006) and modified in part by the *Order on Reconsideration of the Second Report and Order*, WT Docket No. 05-211, 21 F.C.C.R. 6703 (2006), and subject to the present litigation.

§ 1.2110 Designated entities.

(a) Designated entities are small businesses, businesses owned by members of minority groups and/or women, and rural telephone companies.

(b) *Eligibility for small business and entrepreneur provisions.*—(1) Size attribution. (i) The gross revenues of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or licensee) and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules. An applicant seeking status as a small business, very small business, or entrepreneur, as those terms are defined in the service-specific rules, must disclose on its short- and long-form applications, separately and in the aggregate, the gross revenues for each of the previous three years of the applicant (or licensee), its

affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship.

(ii) If applicable, pursuant to § 24.709 of this chapter, the total assets of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship shall be attributed to the applicant (or licensee) and considered on a cumulative basis and aggregated for purposes of determining whether the applicant (or licensee) is eligible for status as an entrepreneur. An applicant seeking status as an entrepreneur must disclose on its short- and long-form applications, separately and in the aggregate, the gross revenues for each of the previous two years of the applicant (or licensee), its affiliates, its controlling interests, the affiliates of its controlling interests, and the entities with which it has an attributable material relationship.

* * * *

(3) *Exceptions.*

* * * *

(iv) *Applicants or licensees with material relationships*—(A) *Impermissible material relationships.* An applicant or licensee that would otherwise be eligible for designated entity benefits under this section and applicable service-specific rules shall be ineligible for such benefits if the applicant or licensee has an impermissible material relationship. An applicant or licensee has an impermissible material relationship when it has arrangements with one or

more entities for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 50 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

(B) *Attributable material relationships.* An applicant or licensee must attribute the gross revenues (and, if applicable, the total assets) of any entity, (including the controlling interests, affiliates, and affiliates of the controlling interests of that entity) with which the applicant or licensee has an attributable material relationship. An applicant or licensee has an attributable material relationship when it has one or more arrangements with any individual entity for the lease or resale (including under a wholesale agreement) of, on a cumulative basis, more than 25 percent of the spectrum capacity of any one of the applicant's or licensee's licenses.

(C) *Grandfathering*—(1) *Licensees.* An impermissible or attributable material relationship shall not disqualify a licensee for previously awarded benefits with respect to a license awarded before April 25, 2006, based on spectrum lease or resale (including wholesale) arrangements entered into before April 25, 2006.

(2) *Applicants.* An impermissible or attributable material relationship shall not disqualify an applicant seeking eligibility in an application for a license, authorization, assignment, or transfer of control or for partitioning or disaggregation filed before April 25, 2006, based on spectrum lease or resale (including wholesale) arrangements entered into before April 25, 2006. Any applicant seeking eligibility in an application for

a license, authorization, assignment, or transfer of control or for partitioning or disaggregation filed after April 25, 2006, or in an application to participate in an auction in which bidding begins on or after June 5, 2006, need not attribute the material relationship(s) of those entities that are its affiliates based solely on § 1.2110(c)(5)(i)(C) if those affiliates entered into such material relationship(s) before April 25, 2006, and are subject to a contractual prohibition preventing them from contributing to the applicant's total financing.

Example to paragraph (b)(3)(iv)(C)(2). Newco is an applicant seeking designated entity status in an auction in which bidding begins after the effective date of the rules. Investor is a controlling interest of Newco. Investor also is a controlling interest of Existing DE. Existing DE previously was awarded designated entity benefits and has impermissible material relationships based on leasing agreements entered into before April 25, 2006, with a third party, Lessee, that were in compliance with the Commission's designated eligibility standards prior to April 25, 2006. In this example, Newco would not be prohibited from acquiring designated entity benefits solely because of the existing impermissible material relationships of its affiliate, Existing DE. Newco, Investor, and Existing DE, however, would need to enter into a contractual prohibition that prevents Existing DE from contributing to the total financing of Newco.

(c) Definitions.—(1) *Small businesses.* The Commission will establish the definition of a small business on a service-specific basis, taking into

consideration the characteristics and capital requirements of the particular service.

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(4) *Rural telephone companies.* A rural telephone company is any local exchange carrier operating entity to the extent that such entity—

(i) Provides common carrier service to any local exchange carrier study area that does not include either:

(A) Any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census, or

(B) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(ii) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(iii) Provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(iv) Has less than 15 percent of its access lines in communities of more than 50,000 on the date of enactment of the Telecommunications Act of 1996.

* * * *

(f) *Bidding credits.* (1) The Commission may award bidding credits (*i.e.*, payment discounts) to eligible designated entities. Competitive bidding

rules applicable to individual services will specify the designated entities eligible for bidding credits, the licenses for which bidding credits are available, the amounts of bidding credits and other procedures.

(2) *Size of bidding credits.* A winning bidder that qualifies as a small business may use the following bidding credits corresponding to its respective average gross revenues for the preceding 3 years:

(i) Businesses with average gross revenues for the preceding years, 3 years not exceeding $3 million are eligible for bidding credits of 35 percent;

(ii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $15 million are eligible for bidding credits of 25 percent; and

(iii) Businesses with average gross revenues for the preceding years, 3 years not exceeding $40 million are eligible for bidding credits of 15 percent.

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§ 1.2111 Assignment or transfer of control: unjust enrichment.

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(d) *Unjust enrichment payment: bidding credits.* (1) A licensee that utilizes a bidding credit, and that during the initial term seeks to assign or transfer control of a license to an entity that does not meet the eligibility criteria for a bidding credit, will be required to reimburse the U.S. Government for the amount of the bidding credit, plus interest based on

the rate for ten year U.S. Treasury obligations applicable on the date the license was granted, as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to assign or transfer control of a license to an entity that is eligible for a lower bidding credit, the difference between the bidding credit obtained by the assigning party and the bidding credit for which the acquiring party would qualify, plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer. If, within the initial term of the license, a licensee that utilizes a bidding credit seeks to make any ownership change or to enter into a material relationship (see § 1.2110) that would result in the licensee losing eligibility for a bidding credit (or qualifying for a lower bidding credit), the amount of the bidding credit (or the difference between the bidding credit originally obtained and the bidding credit for which the licensee would qualify after restructuring or entry into a material relationship), plus interest based on the rate for ten year U.S. treasury obligations applicable on the date the license is granted, must be paid to the U.S. Government as a condition of Commission approval of the assignment or transfer or of a reportable eligibility event (see § 1.2114).

(2) *Payment schedule.* (i) For licenses initially granted after April 25, 2006, the amount of payments made pursuant to paragraph (d)(1) of this section will be 100 percent of the value of the bidding

credit prior to the filing of the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met. If the notification informing the Commission that the construction requirements applicable at the end of the initial license term have been met, the amount of the payments will be reduced over time as follows:

(A) A loss of eligibility in the first five years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 100 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(B) A loss of eligibility in years 6 and 7 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 75 percent of the difference between the bidding credit received and the bidding credit for which it is eligible);

(C) A loss of eligibility in years 8 and 9 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit (or in the case of eligibility changing to qualify for a lower bidding credit, 50 percent of the difference between the bidding credit received and the bidding credit for which it is eligible); and

(D) A loss of eligibility in year 10 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit (or in the case of eligibility

changing to qualify for a lower bidding credit, 25 percent of the difference between the bidding credit received and the bidding credit for which it is eligible).

(ii) For licenses initially granted before April 25, 2006, the amount of payments made pursuant to paragraph (d)(1) of this section will be reduced over time as follows:

(A) A transfer in the first two years of the license term will result in a forfeiture of 100 percent of the value of the bidding credit (or in the case of very small businesses transferring to small businesses, 100 percent of the difference between the bidding credit received by the former and the bidding credit for which the latter is eligible);

(B) A transfer in year 3 of the license term will result in a forfeiture of 75 percent of the value of the bidding credit;

(C) A transfer in year 4 of the license term will result in a forfeiture of 50 percent of the value of the bidding credit;

(D) A transfer in year 5 of the license term will result in a forfeiture of 25 percent of the value of the bidding credit; and

(E) For a transfer in year 6 or thereafter, there will be no payment.

(iii) These payments will have to be paid to the United States Treasury as a condition of approval of the assignment, transfer, ownership change, or reportable eligibility event (see § 1.2114).

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